Real Property and Financial Services Section
Hawaii State Bar Association

Newsletter

April 1992

LETTER FROM THE CHAIR

To attorneys, the word "boilerplate" means the standard wording of a contract. To mountain climbers, "boilerplate" means frozen, crusty, hard-packed snow, often with icy patches.

Insurance, condemnation, and arbitration provisions in real property contracts are referred to as "boilerplate" provisions and, in the drafting stage, are often not given the scrutiny of other contract provisions. It is usually not until the improvements catch fire or the state condemns the property or one party demands arbitration that the mountain-climbing attorney discovers the icy patches in otherwise powdery snow.

This spring our Section has scheduled seminars to discuss what happens when one encounters the "icy patches" in insurance and condemnation provisions.

Jim Watson and Jim Evers discuss arbitration clauses in this issue.

You will notice that this issue contains the Year of the Family Logo. This is a reminder to all of us of the important role played by families in society in general and the roles we each play as family members in particular. The practice of law is a stress-filled and time-demanding profession, but no matter how "important" the legal task at hand, it cannot supplant in importance our obligations to our families.

William J. Deeley
Chair, Real Property &
Financial Services Section
Hawaii State Bar Association ■

UPDATE ON UPCOMING SEMINARS

April 24, 1992	Property and Liability Insurance: Drafting Issues
June 26, 1992	Condemnation Provisions: Drafting Issues
July 17, 1992	Legislative Update
October 16, 1992	Real Property Litigation Update
November 24, 1992	Conveyance Manual III

FIVE-YEAR REVIEW OF LAND USE DISTRICT BOUNDARIES

Pursuant to the state Land Use Law (HRS 205-18) the Office of State Planning (OSP) has undertaken the required 5-year review of land use district boundaries set originally (and thereafter modified by petition) by the state Land Use Commission (LUC). All of the land in the state falls into one of these districts. Draft findings and recommendations for all four districts (urban, rural, agricultural and conservation) are presently circulating for public review and comment.

The draft reports, island by island, are available together with baseline studies and consultant reports, at state regional public libraries and the Department of Business, Economic Development and Tourism library. OSP contemplates submitting its final recommendations and findings to the LUC in September. It will then be up to the LUC to schedule contested case hearings to consider the recommendations for boundary amendments. Affected landowners will receive copies of petitions for boundary amendments affecting their land. Present drafts suggest modest increases in land classified in the urban district, and substantial reclassification of land into the conservation district from the agricultural district, all in accordance with state constitutional, statutory, state general plan (HRS 226 et seq.) and county general and development plan standards and criteria. Since the legislature deleted (in the 1970s) then reinserted (in the 1980s) the five-year boundary review requirement, this is the first such comprehensive boundary review in nearly 20 years. For further information (including fact sheets and summaries of recommendations for reclassifications) contact the Office of State Planning, Office of the Governor, P.O. Box 3540, Honolulu, Hawaii 96811-3540 (Tel. 587-2800). ■

POOL REGULATIONS AND THE FAIR HOUSING ACT

The local enforcement official of the Department of Housing and Urban Development has taken the position that any entity covered by the Fair Housing Act, e.g. residential apartment owners and condominium associations, cannot impose restrictions or implement rules affecting only children because such rules are discriminatory. For example, according to that official, such entities cannot post signs restricting children under a certain age from utilizing the pool without being accompanied by an adult, although this had been the language recommended by liability insurance carriers. It should be noted, however, that, in response to a written request, the Assistant Secretary of the Department of Housing and Urban Development noted that the preamble to the implementing regulations of the Act notes that housing providers may make reasonable rules to protect the health and safety of children. While declining to address whether various specific house rules comply with the "reasonableness" requirement, the Assistant Secretary did state that segregating swimming pools or other facilities as "adult only" or "children only" would violate the Act. In any event, it appears that such signs may need to be modified, and any such modifications should be coordinated with liability insurance carriers. ■

REVISED CONVEYANCE TAX FORM NOW AVAILABLE

Beginning this month with respect to conveyance tax forms, and beginning this past March with respect to the exemption from conveyance tax form, the Bureau of Conveyances will accept only the newly revised forms P-64A (Conveyance Tax Certificate) and P-64B (Exemption from Conveyance Tax). Copies of the new forms are now available from the Department of Taxation. ■

CONVEYANCE MANUAL III

Gino Gabrio, Jack Rolls, Gail Tamashiro and Mel Kaneshige are spearheading the update of the Conveyance Manual, which will be presented at a seminar during the Hawaii State Bar Convention in November. If you have any suggestions for additional materials you would like to see included in the Manual, changes to existing materials or forms, or any other input, please contact Gino Gabrio at 521-9200. ■

DID YOU KNOW . . .

- Notwithstanding the language contained in most mortgages and leases, the term "extended coverage" is an obsolete term. The terminology and types of coverage available were changed by the insurance industry several years ago.
- If non-conforming, but grandfathered improvements are not completely destroyed by a casualty but are damaged to such a degree that applicable regulations require that the improvements be completely demolished before a new building can be constructed, unless the owner's hazard insurance policy has a special endorsement, the owner will only receive insurance proceeds for the actual damage caused by the hazard, and not the full value of the building, even though it must be demolished.
- You can learn about these and other similar issues and drafting problems affecting common insurance provisions contained in leases, mortgages and other agreements at the half-day insurance seminar co-sponsored by the Section and HICLE, to be held April 24th at the Ala Moana Hotel starting at 8:15 a.m. To register for the seminar, please contact HICLE at 956-6551. ■

ARBITRATION CLAUSES– WHO DETERMINES ENFORCEABILITY?

By James H. Watson
James F. Evers

Some Hawaii practitioners may not be aware that applying Hawaii's arbitration law in Chapter 658, Hawaii Revised Statutes, can require a critical enforceability analysis. This analysis becomes important when one party to a written agreement containing an arbitration clause demands arbitration of a later dispute over nonperformance, but the other party has grounds to raise a threshold argument that the arbitration clause is not binding because it is part of a writing which, even though signed, is not a valid, enforceable contract.[1]

The inquiry in this circumstance turns (1) to Section 658-1, which lends enforceability to an arbitration provision "in a written contract" unless there are grounds for "revocation" of the contract, and (2) to Section 658-3, which permits the party demanding arbitration to apply for a circuit court order compelling arbitration. Upon hearing, the court decides whether "the making of the agreement" is in issue. If so, there is a trial of that issue. A trier-of-fact's finding "that no agreement in writing providing for arbitration was made" means no arbitration, whereas arbitration is ordered upon a finding "that a written provision for arbitration was made" but not performed.

Do these clauses in Sections 658-1 and -3 mean that the court will sometimes compel arbitration if there is merely some writing signed by the parties and containing an arbitration clause, without deciding clearly whether there was legal consideration, mutuality of assent, or sufficient definiteness of terms to make the writing enforceable as a contract? If so, the arbitrator would decide the contract validity/enforceability issues. Or, when the issue arises, must the court make a finding that the writing rises to the dignity of a binding contract, thus leaving to the arbitrator only questions of default and remedies?

Read together as they should be, the literal terms of Sections 658-1 and 658-3 are ambiguous on this question. By use of the terms "contract" and "revocation," Section 658-1 at least implies that going into arbitration turns on whether the underlying writing reaches the level of a binding deal, even if there is voidability ("revocation") for reasons such as fraud or mutual mistake. Section 658-3, however, uses only the word "agreement" in the crucial clause "making of the agreement" and equivalent terms. In the common legal lexicon, an agreement may include either a valid, enforceable contract or a mere signed writing with validity or enforceability defects. The interplay of common meanings of terms in Sections 658-1 and -3 therefore suggests that a court could either (1) throw the matter of underlying contract enforceability to an arbitrator on the basis of a signed writing that may or may not be binding, or (2) decide the enforceability issue itself.

Practitioners ought to care whether a court or an arbitrator decides such basic issues of contract law, not only because of cost and time required, but also because the decision maker's identity could well affect results. Having an arbitrator decide close questions involving technical contract law on consideration, mutuality, definiteness, and the like in a relatively free-wheeling arbitration context may lead to a different decision from that of a court who formally applies contract law principles.[2] Efficient case management also demands that attorneys know how a court will approach this

question. It may be relatively easy for the attorney to determine on his own investigation whether his client and another party merely signed some purported written agreement with an arbitration term; if so and if merely having or not having such a writing is the standard, pursuing a court decision on that question could be wasteful. In comparison, the question whether contract law will bind one's client to what was signed may be harder to answer with certainty, which a preliminary court ruling would provide.

Practitioners may also focus on appeal standards. A circuit court's decision to stay or compel arbitration on grounds applicable under Section 658-3 presumably would be subject to general appellate review for error. See Association of Owners of Kukui Plaza v. Swinerton & Walberg, 68 Haw.98, 104-07, 705 P.2d 28, 33-35 (1985). In contrast, an arbitrator's award may be vacated, modified, or corrected only for limited, specific reasons under H.R.S. Section 658-9 or -10, and an arbitrator's error in applying the law, finding facts, construing terms, or even in entering an award contrary to the evidence, is not necessarily enough for reversal. University of Haw. Prof. Ass'y v. University of Haw., 66 Haw. 214, 224-25, 659 P.2d 720 (1983); Mars Constructors, Inc. v. Tropical Enterprises, Ltd., 51 Haw.332, 460 P.2d 317 (1969).[3]

As to legislative history, Act 276 of the 1925 Hawaii Session Laws placed in Hawaii's statutes essentially the same provisions that Sections 658-1 and -3 contain today. The sparse legislative committee statements indicate only that the intent was to provide for enforcement of arbitration agreements made before a dispute arises and that Act 276 followed uniform arbitration statutes adopted in other states.[4] See Stand. Comm. Rep. No. 436, 1925 HAW. SENATE JOUR. at 1124. This history is too meager to remove the ambiguity in express statutory terms of Chapter 658.

Although Hawaii's appellate court decisions may have some applicability to the issue of concern here, the decisions have never spoken to the issue with sufficient directness and precision to guide lower courts in the face of such ambiguous statutory terms. Two recent cases in this area are Leong v. Kaiser Foundation Hospitals, 71 Haw. 240,788 P.2d 164 (1990) and Westin Hotel Co. v. Universal Investment, Inc., 72 Haw. 178, 811 P.2d 467 (1991).

In Leong, the Supreme Court stated that a party who tried to block arbitration would be entitled to a jury trial by the lower court on "issues relating to whether there is an enforceable agreement to arbitrate." 71 Haw. at 244 (Emphasis added). This statement indicates that the threshold from Section 658-3 to arbitration is a non-arbitrator's determination of enforceability, but the issue that the Leong court addressed when it made the above statement was whether the wording about default in Section 658-3 applies to a refusal to proceed with arbitration or a refusal to perform the underlying agreement. The court was not speaking directly to the enforceability issue that is discussed in this article.

In Westin, the party against whom arbitration of a dispute was pressed ignored a demand for arbitration, evidently because the party's counsel believed his client had not signed a letter authorizing an agent to make the written agreement in which an arbitration clause appeared. After the unilateral arbitration hearing but before rendering his award, the arbitrator specially invited further written evidence from the absent party. Only then did that party formally assert its claim that no agreement to arbitrate existed. The arbitrator decided that there was a contract to arbitrate and rendered an award against the objecting party. On appeal of an order denying confirmation of that award, the Supreme Court majority recognized contrary evidence that the letter of authority had been signed, invoked Hawaii's strong public policy favoring arbitration, and held that the defense of no contract came too late. The court disposed of the case without further lower court proceedings by directing entry of an order confirming the award. The majority reasoned that late assertion of the defense warranted such result because otherwise, the lower court would have been able to determine whether an agreement to arbitrate existed. This statement, however, falls short of defining the standard under Sections 658-1 and -3 because the only thing the lower court would have determined was whether the authority letter had been signed.

The well-reasoned dissent of Supreme Court Justice Moon in the Westin case comes close to answering the question discussed in this article. The dissent is enough to make a student of the case believe that a court should not permit an arbitrator to decide whether the underlying writing is a valid, enforceable contract. Justice Moon would have remanded the case for a lower court trial on the enforceability issue.

In Justice Moon's rationale, the jurisdiction of an arbitrator arises only if it is determined preliminarily that the writing which contains an arbitration clause merits enforceability as a valid contract. When enforceability is in issue, it is the court that decides whether the writing meets requisite standards to be treated as a contract. The arbitrator cannot create his own jurisdiction by deciding whether those standards are met. That question is solely a judicial question. 72 Haw. at 185-89. Put another way, if the arbitrator should find no contract, then the arbitrator had no jurisdiction to make that finding in the first place and the result is not only inefficient but absurd.[5]

Justice Moon's reasoning is persuasive whether enforceability turns on questions of fact or issues of law, and his dissent is supported by a significant group of case authorities from other states. See, e.g., Arrow Overall Supply Co. v. Peloquin Enterprises, 414 Mich. 95, 323 N.W.2d 1 (1982) (cited in Westin dissent); Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463 (1961) (Froessel, J., concurring opinion); Finsilver, Still & Moss v. Goldberg, Maas & Co., 253 N.Y. 382, 171 N.E. 579 (1930) (Benjamin Cardozo, C.J., author); Dougherty v. Mieczkowski, 661 F.Supp. 267 (D. Del. 1987). The underlying fundamental point is that since the contract is the essential source of an arbitration tribunal's very existence, arbitration should not proceed until a court determines contract validity; without the contract any award would be a nullity.

The Westin case provokes an interesting policy analysis. The court's majority decision was driven by a well-established policy that arbitration of disputes is favored over court litigation. See Gadd v. Kelley, 66 Haw.431, 436 (1983). On the other hand, the dissent argued that other policies should be considered, such as the importance of maintaining a good business climate in Hawaii. There is, however, a better statement of competing policies when the question is essentially whether the court or an arbitrator should decide validity or enforceability of the arbitration clause. Should a pro-arbitration policy outweigh the policy behind contract law which states that only writings which meet fundamental legal tests will be enforced? If the arbitration clause is in a writing whose other, basic performance terms would not be enforced, then allowing an arbitrator to decide validity or enforceability pursuant to that clause arguably flaunts basic contract law.

Any policy analysis also ought to consider whether bypassing a court ruling on threshold enforceability issues really serves judicial economy. If arbitration is ordered without that ruling and the award may be challenged as a nullity, then parties are forced to the expense and burden of arbitration without a real resolution, and some parties may try to use arbitration as only a special discovery process. On the other hand, if parties may not challenge awards even when the awards are rendered pursuant to arbitration clauses in writings that are not binding, parties will fear arbitration clauses. Merely signing a writing with an

arbitration clause could force parties to complete full arbitration on merits of a dispute even when contract law would protect them from having to perform the other terms.[6] This would discourage use of arbitration clauses, and such results would undercut Hawaii's arbitration policy.

These thoughts suggest that the policies underlying both basic contract law and arbitration statutes are served by making it clear that whenever bona fide issues of contract validity or enforceability exist, those issues must be resolved by the court before any arbitration can proceed. Had that kind of policy emphasis been in focus when Westin was decided, the result in that case may have been different.

Resourceful attorneys whose clients' interests are reserved by arbitration might try drafting arbitration clauses that expressly deal with the validity or enforceability of the underlying contract. Skillfully worded terms might avoid objections to the arbitration clause on bases that would support a legal attack on the underlying agreement. See Gregg Kendall & Assoc., Inc. v. Kauhi, 53 Haw. 88, 97 (1971)(Footnote 2).[7] This approach, however, would likely not be the optimum way to serve arbitration policies, because different provisions could produce inconsistent results, parties might still fear signing such a term, and it would still be part of, or irrevocably connected with, the underlying agreement. A Hawaii appellate court could render a clarifying decision, but that would have to await an appropriate case, might be fact-specific and distinguishable from other situations, and would not actually rewrite the ambiguous statutory terms. The best solution would be a legislative amendment to Chapter 658 in which the ambiguity is removed.

Let us hope that further action on this matter, whether legislative or judicial, will be based on the principles reflected in Justice Moon's dissent in Westin. The policy of promoting efficient dispute resolution could be well served by such action.

FOOTNOTES

1 This situation is distinguished from an agreement to arbitrate that is made after controversy arises.

2 This would be especially true if the arbitrator is not well trained in contract law principles.

3 An arbitrator's award may be vacated, however, if the arbitrator exceeded his powers. H.R.S. Section 658-9(4).

4 See Sections 1 and 2 of the UNIF. ARBITRATION ACT, 7 U.L.A. 5, 68 (1985), on which Sections 658-1 and 658-3 are based. A number of cases from other states are cited under Sections 1 and 2 of the Act on the question of whether an arbitration contract existed. Examination of those cases is beyond the scope of this article.

5 Chapter 658 does not confer any independent jurisdiction upon an arbitrator, but only seeks to make arbitration terms valid and enforceable.

6 Some parties might also be deterred from using arbitration clauses by another shortcoming of Section 658-3. While the section provides a method for a party who desires arbitration to compel it, there is no provision for an application to stay arbitration. Uniform Arbitration Act Section 2, which 658-3 otherwise parallels, contains a provision for such applications to stay.

7 An argument that the arbitration term is severable from the underlying agreement would be a poor attempt at resolution of the problem because it would still create fear of arbitration clauses and Section 658-1 still defines the"controversy"(which may be over enforceability) as one "arising out of the contract." ■

YEAR OF THE FAMILY

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