



## Can Builders Still Require New Home Purchasers to Participate in Mandatory Binding Arbitration?

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Recent judicial decisions in California have demonstrated that it is very difficult for a home or condominium developer or builder to require a home buyer to participate in binding arbitration or judicial reference authorized by Code of Civil Procedure §638 in order to avoid the length and added cost of a jury trial on any homeowner claims, including claims of construction defects. Several recent judicial decisions have refused to enforce binding arbitration clauses contained in home purchase contracts, addenda to home purchase contracts or in recorded declarations of covenants, conditions and restrictions ("CC&Rs"), as discussed in detail below. In addition, although there has been a recent trend toward enforcing judicial reference provisions in residential home purchase and sale agreements, a recent California Supreme Court case calls into question how many trial courts will exercise their discretion under Code of Civil Procedure §638 and actually refer homeowner lawsuits against developers and builders to judicial reference.

The two issues that most concern the courts with respect to binding arbitration clauses are whether or not the home buyers knowingly agreed to the arbitration clause and whether the arbitration clause is unconscionable. Unconscionability typically has two components, procedural unconscionability and substantive unconscionability. Procedural unconscionability relates to the manner in which the parties negotiated the contract, including the relevant circumstances of the parties at the time, and the factors of oppression and surprise. Substantive unconscionability relates to whether the contractual terms produce unfair or one-sided results which should not be enforced.

In a judicial reference, the court appoints a referee, usually based on the written agreement of the parties, who will determine some or all of the issues of fact and law in a lawsuit. A "general" reference under Code of Civil Procedure §638 means all issues of fact and law in the case are determined by the reference. A "special" reference means only specific issues are determined by the referee. Courts may enforce a contractual provision requiring a general judicial reference and will direct the referee to try all of the issues in the case pursuant to a hearing before the referee that is conducted according to the rules of evidence that apply in judicial proceedings. The referee will prepare a statement of decision, which becomes the decision of the trial court which may be reviewed by an appeal. (Treo @ Kettner Homeowners Assn. v. Superior Court (Inter Gulf Construction Corporation), 166 Cal.App.4th 1055, 1061 (2008); Trend Homes, Inc. v. Superior Court, 131 Cal.App.4th 950, 955-956 (2005).)



A review of the recent court of appeal decisions relating to new home purchase contracts and related documentation demonstrates that it is very typical for home builders to include mandatory binding arbitration provisions and/or judicial reference provisions in the purchase contract, other purchase documents or the CC&Rs. Typically, the binding arbitration provisions and the judicial reference provisions cover any and all claims or disputes that a home buyer might have against the developer, including claims for construction defects, and are not limited to just issues relating to or covered by the purchase agreement for the residence. The goal of the developer appears to be to prevent the homeowner from bringing any claims that they might have via a lawsuit in the case of the binding arbitration clause or to prevent the homeowner's claims from being decided by a jury in the case of a judicial reference provision.

### **Binding Arbitration Agreements**

As a threshold issue, Code of Civil Procedure §1298.7 prohibits the enforcement of a binding arbitration provision in a purchase contract to convey real property to the extent it tries to preclude or limit any ability of a property purchaser to file a lawsuit for construction defect, bodily injury, or wrongful death. (*Pinnacle Museum Tower Assn. v. Pinnacle Market Development (U.S.), LLC*, 187 Cal.App.4th 24, 33 (2010);<sup>[1]</sup> *Villa Milano Homeowners Assn. v. Il Davorge*, 84 Cal.App.4th 819, 829-830 (2000).) Therefore, developers or home builders are prevented by statute from placing an arbitration provision that applies to construction defect actions in a home or condominium purchase agreement.

Four of the most recent cases dealing with mandatory binding arbitration clauses in home purchase agreements or related documents, *Villa Vincenza Homeowners Assn. v. Nobel Court Redevelopment, LLC*, 191 Cal.App.4th 963 (2011); *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (U.S.), LLC*, 187 Cal.App.4th 24, 33 (2010);<sup>[2]</sup> *Bruni v. Didion*, 160 Cal.App.4th 1272 (2008); and *Baker v. Osborne Development Corp.*, 159 Cal.App.4th 884 (2008), have all ruled binding arbitration clauses in such documents unenforceable. In *Villa Vincenza* and *Pinnacle Museum Tower*, the developer attempted to insert a binding arbitration clause covering construction defect claims and any other causes of action against the developer in the recorded set of CC&Rs applicable to the project. Both courts ruled that a set of CC&Rs containing a binding arbitration clause that is recorded before virtually any of the homeowners have purchased their homes, does not constitute a sufficient "agreement" between the association or its homeowner members and the developer required to force the matter into binding arbitration. The association did not expressly agree to be bound by binding arbitration because it was not a party to the CC&Rs prior to the developer recording them and the association did not exist until the developer sold the first unit. In addition, the courts felt that the association had no choice but to accept the first property that the developer deeded to it creating the association thereby allegedly binding it to the mandatory arbitration clause. Furthermore, the courts ruled that a developer should not be permitted to accomplish through recorded CC&Rs that it controls what it cannot accomplish directly in the purchase contract as Code of Civil Procedure §1298.7 prohibits binding arbitration clauses applicable to construction defect claims in purchase contracts.

In both *Bruni* and *Baker*, the courts of appeal affirmed trial court rulings that a mandatory binding arbitration clause contained in a written limited warranty provided by the developer at the time of purchase were unenforceable as they were unconscionable. These courts felt that the lengthy arbitration provisions were part of a contract of adhesion set forth in single-spaced type and buried in a voluminous amount of documents provided to the home buyer at the time of signing the purchase contract for the home. The terms of the arbitration agreement were contained in documents that were either only summarized for the home buyer, shown to the home buyers (but copies not provided), or where copies were provided with a large volume of other contract documents, but the home buyer was not directed to initial or sign anywhere near the terms of the arbitration provision. In essence, the courts felt that the arbitration clause and its rules and procedures were presented to a home buyer with little bargaining power on a take-it-or-leave-it basis by the developer. These courts also ruled that the mandatory arbitration provisions were substantively unconscionable because they were



unduly one-sided in favor of the developer as they only barred from litigation claims that would only be typically brought by homeowners against the developer. Furthermore, the full breadth of the reach of the arbitration clause also did not match the reasonable expectations of the purchasers. These arbitration clauses were contained in documents relating to the limited home warranty being provided by the developer for the homeowner. The courts felt that it would not be in the buyer's reasonable expectation to believe that a document related to the limited warranty protecting the home would also prevent the home buyer from bringing a construction defect suit or any other litigation not related to the developer's performance under the limited warranty.

### **Judicial Reference**

Currently, the developer has a better chance of having a judicial reference provision in a purchase contract upheld than a binding arbitration clause. Much like in the Villa Vincenza and the Pinnacle Museum Tower cases, which refused to enforce arbitration clauses contained in CC&Rs, the court in *Treo @ Kettner Homeowners Assn. v. Superior Court (Inter Gulf Construction Corporation)*, 166 Cal.App.4th 1055 (2008), ruled that a judicial reference provision contained in set of CC&Rs recorded against a condominium project was not enforceable. The recording of a judicial reference provision in a set of CC&Rs did not constitute a "contractual" waiver of the right to jury trial pursuant to the judicial reference provision set forth in Code of Civil Procedure §638. However, several courts have upheld judicial reference provisions contained in purchase and sale contracts which required home buyers to submit all claims, including construction defect claims, against the developer to judicial reference. (*Trend Homes, Inc. v. Superior Court*, 131 Cal.App.4th 950, 955-956 (2005); *Greenbriar Homes Communities, Inc. v. Superior Court (Albert Couris)*, 117 Cal.App.4th 337 (2004); *Woodside Homes of Cal. Inc. v. Superior Court (C.I. Folger, Jr.)*, 107 Cal.App.4th 723 (2003).)

The judicial reference provision in *Trend Homes* was contained in the actual purchase and sale agreement signed by the home buyers. The court found that the judicial reference provision was not unconscionable citing the fact that it was clearly set forth in all caps in an only 9-page purchase agreement. It was also specifically initialed by each home buyer at the bottom of the judicial reference provision. Furthermore, the plaintiff homeowners did not put on any evidence in opposition to the developer's motion for appointment for a referee to show that the judicial reference provision was non-negotiable. The court felt that the fact that there was an initial line for the homeowner beneath the judicial reference provision indicated that the buyer could negotiate that provision. (p. 958) In addition, the plaintiffs did not put on evidence that they were not allowed sufficient time to read the purchase contract or to have it reviewed by a real estate professional or an attorney before signing the agreement, or that they were pressured by the developer to sign it before reviewing it carefully. (p. 959) Lastly, the court felt that the language of the judicial reference provision in that contract was easily understood by a home buyer. (p. 960)

*Greenbriar Homes Communities, Inc. v. Superior Court (Albert Couris)*, 117 Cal.App.4th 337 (2004), also involved a judicial reference provision contained directly in the purchase agreement entered into between the developer and the home buyer. The court found that the judicial reference provision was not unconscionable as it appeared in the same font style and size as the rest of the purchase contract and was located immediately above the signature block on the last page that the purchasers signed. The court felt that the provision was easily understood and not buried in a purchase agreement or other related documents, but was located in a position where the purchaser was almost certain to see it when signing the agreement. (p. 345) The court also felt that the provision was not substantively unconscionable because it in no way limited the amount or type of remedy or relief that the homeowners could seek in litigation. The court also noted that the provision set forth that the referee's fees would be shared equally by the parties. (p. 345)

In *Woodside Homes of Cal. Inc. v. Superior Court (C.I. Folger, Jr.)*, 107 Cal.App.4th 723 (2003), the court also upheld a judicial reference provision. The *Woodside Homes'* court did not feel that the judicial reference provision was misleading or hard to understand. It was contained in a short, only several-page contract, not buried in voluminous contract documents. Furthermore, the home buyers all



initialed the judicial reference provision. As in *Greenbriar Homes*, the judicial reference provision did not take away any rights or remedies that the home buyers could pursue through litigation and judicial reference and allocated the referee's fees equally between the parties. (p. 730)

Despite these recent cases enforcing judicial reference provisions, a very recent California Supreme Court case, *Tarrant Bell Property, LLC v. Superior Court (Abaya)*, 51 Cal.4th 538 (2011), has called into doubt the future enforceability of judicial reference provisions in home purchase contracts in certain types of cases. In *Tarrant Bell*, the California Supreme Court ruled that trial courts have discretion under Code of Civil Procedure §638 not to order the appointment of a judicial referee even where some, or a good portion of all, of the plaintiffs' home purchase contracts contain an enforceable written judicial reference provision. The California Supreme Court ruled that the trial court has judicial discretion under section 638 to deny judicial reference where there is a danger of inconsistent verdicts or where it would not serve the interest of judicial economy. In *Tarrant Bell*, approximately 100 of the 120 named plaintiffs had signed purchase agreements that contained a judicial reference provision. Therefore, if the trial court ordered judicial reference for the 100 plaintiffs who signed contracts with the judicial reference provisions, there would be a danger of inconsistent results between the judicial reference decision for 100 of the plaintiffs versus the jury or court trial decision in the remaining case involving the 20 remaining homeowners not subject to the judicial reference provision. In addition, the court was concerned that requiring two different trials, one involving a referee and one involving a court or a jury, would not be in the interest of judicial economy or save the parties any money. The *Tarrant Bell* decision could be problematic in the future for developers attempting to enforce judicial reference provisions. It appears with some regularity that some, but not all, of the purchase contracts in condominium or home subdivision sales cases contain a judicial reference provision.

We will soon receive further guidance in this area of the law once the California Supreme Court issues its opinion in *Pinnacle Museum Tower Assn.*, which will address whether the Supreme Court will enforce binding arbitration provisions only contained in CC&Rs against members of the homeowner association or against the association itself.

[1] The Supreme Court recently granted review of this decision.

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