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Arbitration in California Construction Defect Cases After *AT&T Mobility v. Concepcion*

By Timothy J. Toohey

The U.S. Supreme Court's recent decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. ___, 131 S.Ct. 1740 (2011) (*Concepcion*) has engendered considerable controversy for upholding arbitration provisions in consumer contracts containing class action waivers. Importantly for the construction industry, the decision may impact other types of cases in which California courts have found arbitration provisions unenforceable, including construction defect cases brought by homeowners or condominium associations against developers.

In *Concepcion*, the Court invalidated the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 162 (2005), which held that


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class action waivers in certain consumer contracts are unenforceable on unconscionability grounds. The *Concepcion* Court held that rejecting arbitration because of a class action waiver violated Section 2 of the Federal Arbitration Act (FAA), which specifies that agreements to arbitrate are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The *Concepcion* Court also found that the *Discover Bank* rule was preempted because it was an obstacle to the accomplishment of the FAA's objectives—encouraging efficient and quick dispute resolution through arbitration—because it was "applied in a fashion that disfavors arbitration" by California courts.

Although the *Concepcion* decision has attracted commentary, much less attention has been paid to the impact of *Concepcion* on California cases holding that arbitration provisions are unenforceable because they are part of a contract of adhesion. Justice Scalia's majority opinion in *Concepcion* clearly expressed the Court's displeasure for what it viewed as the propensity of California courts to refuse to enforce arbitration provisions in private contracts. Noting that "California's courts [are] more likely to hold contracts to arbitrate unconscionable than other contracts," the Court likened such tendency to the "judicial hostility towards arbitration that prompted the FAA." Nor did the Court look any more favorably on California courts' justification for rejecting arbitration agreements, *i.e.*, that they were part of a contract of adhesion. Indeed, the Court made short shrift of this argument by stating that "the times in which consumer contracts were anything other than adhesive are long past."

The broader criticism levied by the Court in *Concepcion* against invalidating arbitration provisions on grounds of unconscionability logically extends to recent cases in which the Court of Appeals has invalidated arbitration provisions in construction defect disputes on those grounds. One of the more significant decisions in this area is *Baker v. Osborne Development Corp.*, 159 Cal. App. 4th 884 (2008), in which the court held that an

arbitration provision in a new home warranty program established by a builder was unenforceable as an unconscionable contract of adhesion. One factor considered by the *Baker* court was that the arbitration provision at issue was not included in a contract between the homebuyer and the builder, but was rather found in a document "that purported to be an application by the builder to obtain a warranty from [the warranty program administrator]." The court concluded that "there is no evidence the arbitration agreement was a negotiable term and it appeared to be a contract of adhesion" and that "[t]he arbitration agreement at issue in the present case was … one-sided." *See also Bruni et al. v. Didion et al.*, 160 Cal. App. 4th 1272, 1293 (2008) (arbitration provision in home warranty program was part of a contract of adhesion and therefore unenforceable).

In *Thompson et al. v. Toll Dublin, L.L.C. et al.*, 165 Cal. App. 4th 1360, 1364 (2008), which also involved construction defect allegations, the Court of Appeals similarly invalidated arbitration provisions on unconscionability grounds. The court found that the arbitration provisions received by the homeowners in a "Title 7 Master and Dispute Resolution Declaration (Compliance with Civil Code)" and "Declaration of Covenants, Conditions and Restrictions" (CC&Rs) were unconscionable because they had been signed by the developer "more than two years before any plaintiff closed escrow on a home," were "imposed on all buyers of the 264-home project," and were part of "some 800 pages" of documents received and acknowledged by purchasers. Because of the "pervasiveness of the unconscionable provisions related to arbitration and the fact that the purported scope of the arbitration provisions exceeded plaintiff's reasonable expectations," the court in *Thompson* held there were "no isolated provisions that can be severed and the arbitration provisions as a whole are unenforceable against plaintiffs."

Although *Concepcion* indicates that the practice may be preempted by the FAA, California courts may continue

to invalidate arbitration provisions in what it views as contracts of adhesion. Recent cases show that California courts may continue to do so either by taking a narrow view of the application of *Concepcion* or by applying procedural principles, such as standing or waiver.

Sanchez v. Valencia Holding Col, LLC, 200 Cal. App. 4th 11, 2011 Cal. App. LEXIS 1327 (2011), is an example of the former approach. In *Sanchez*, the California Court of Appeals narrowed *Concepcion* by ignoring the broader implications of the Court's opinion. The court rejected an arbitration provision contained in an automobile purchase agreement *not* because it contained a class action waiver, but because the "the arbitration provision *as a whole* is unconscionable." The court concluded that the arbitration provision, which was located on the last page of an agreement "in small font with reduced line spacing," was "procedurally unconscionable because it is adhesive and satisfies the elements of oppression and surprise; it is substantively unconscionable because it contains terms that are one-sided in favor of the car dealer to the detriment of the buyer."

Promenade at Playa Vista Homeowners Assoc. v. Western Pacific Housing, Inc., 2011 Cal. App. LEXIS 1400 (November 8, 2011), demonstrates the latter approach, *i.e.*, invalidating arbitration agreements on procedural, rather than unconscionability grounds. In *Promenade at Playa Vista*, the Court of Appeals held that a developer could not compel binding arbitration pursuant to an arbitration provision in the CC&Rs because they were equitable servitudes, not a contract to arbitrate. The court found that the developers had no standing to enforce CC&Rs once they had completed the project and sold the units because they lacked the ownership interest necessary to enforce an equitable servitude. The court thus avoided not only *Concepcion*, but also whether the CC&Rs were unconscionable—an issue which is currently before the California Supreme Court in *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC*, 187 Cal. App. 4th 24 (2010) (opinion superseded by grant of review). *See*

also Roberts v. El Cajon Motors, Inc., 2011 Cal. App. LEXIS 1399 (November 8, 2011) (no need to determine issue whether waiver of class wide relief was preempted by *Concepcion* because defendant had waived arbitration by waiting five months to invoke arbitration).

Arbitration Versus Litigation

Given that California courts may continue to find arbitration provisions unenforceable, should a party to a construction defect case press for arbitration or be content with litigation? The answer depends upon consideration of both the advantages and disadvantages of arbitration.

Although its virtues are frequently lauded, arbitration has several disadvantages as compared to litigation. For example, arbitrators are bound by the agreement to arbitrate according to the rules of a particular organization (*e.g.*, the American Arbitration Association), not by the rules of procedure, evidence or case law. Discovery, including depositions, which may be strategically useful in some disputes, is severely curtailed or eliminated altogether in arbitration. Parties may thus find themselves at an arbitration hearing without a clear idea of the testimony to be given by witnesses for the opposing party and without the safeguards afforded by the rules of evidence.

A party unhappy with the outcome of an arbitration also faces an uphill battle in challenging the results in a trial court with no appeal to a higher court, even if party believes the arbitrator committed errors of law. Harmonizing conflicting or inconsistent arbitration provisions in multiple contracts presents challenges in an arbitration that may be more acute than in litigation, where courts are accustomed to addressing disputes with multiple parties and conflicting contractual provisions.

In cases involving multiple parties, arbitration may not be that much less expensive than proceeding in state court, particularly when filing fees, fees for arbitrator

services, expert fees and ancillary costs are taken into account. Although arbitration is usually considerably faster than litigation, particularly in these days of budget shortfalls, speedier resolution may not always be an advantage or may come with too high a price, given the sacrifice of the procedural and substantive safeguards afforded by litigation.

In short, parties to construction disputes, like those to any other type of dispute, should carefully assess the pros and cons of both arbitration and litigation before deciding on a course of action and discuss this decision beforehand with knowledgeable counsel.

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