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Legal Alert

California Appellate Courts Continue to Limit Alternative Dispute Resolution for Developers

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Within the past month, two cases decided by the California Appellate Court have ruled against arbitration and judicial reference provisions in home builder sales documents. The two cases were decided based on different legal reasoning, but each potentially have the end effect of **limiting the ability of builders to require homeowners' associations and home buyers to waive their rights to a trial by jury in construction defect claims.**

Builders should consult with their legal counsel to:

- conduct a careful analysis of their purchase agreements, CC&Rs and other sales documents to be sure that their language meets the new "specificity" criteria of *Thompson* (described below).
- review their sales procedures and, if necessary, modify and monitor how ADR provisions are presented and explained to their buyers in order to avoid the unconscionability factors set forth in *Intergulf* (described below).

Not doing so could have the consequence of having post-closing disputes between the association or home buyers and the developer tried before a jury.

The *Thompson* Decision: On August 13, 2008, in *Thompson v. Toll Dublin, LLC, et al.*, No. A116856 (Cal. Ct. App. filed Aug. 13, 2008), the First District of the California Court of Appeal ruled that the alternative dispute resolution ("ADR") provisions in the builder's form of purchase agreement was limited to the types of claims specifically set forth in the ADR provisions, all of which related to construction defects, and that such ADR provisions did not extend to the fraud-related claims filed against the builder.

More interestingly, the Court went on to say that, even if the ADR provisions had been drafted more clearly regarding the scope of the ADR, the provisions were included in an unconscionable and unenforceable "contract of adhesion." The ADR provisions were found to be unconscionable due to a variety of factors, including the inability of the buyers to negotiate the ADR provisions, an inequality of bargaining power between the parties and the fact that the sales documents were so voluminous that the ADR provisions were a "surprise."

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The first part of the holding in *Thompson* could potentially be avoided by a careful review of the ADR language in all sales documents to ensure that the scope of the ADR provisions clearly and accurately reflects every circumstance to which the builder intends the ADR provisions to apply. The second portion of the *Thompson* holding regarding unconscionability could arguably be interpreted as dictum, as the Court was not asked to rule on the unconscionability of the agreement, and only addressed the issue after already deciding the case based on the "ADR scope" argument. However, the unconscionability rationale is troubling and builders should pay close attention to the Court's dictum and tailor their sales procedures in a manner that would avoid such a finding. Broadly interpreted, the Court's statements would apply to all printed form arbitration provisions, whether included in real estate purchase and sale agreements, CC&Rs, personal service contracts, agreements for doctors' and hospitals' medical services and other types of agreements.

The *Intergulf* Decision: On September 12, 2008, the Fourth District of the California Court of Appeal ruled that a recorded Declaration of Covenants, Conditions and Restrictions ("CC&Rs") cannot be construed as a written contract that is sufficient to waive the right to trial by jury. *Treo @ Kettner Homeowners Assoc. v. Intergulf Constr. Corp,* No. D052402 (Cal. Ct. App. filed Sept. 12, 2008). In doing so, the Court rejected a longstanding principle that provisions in CC&Rs that require a jury trial waiver are enforceable against homeowners associations and subsequent home owners that are subject to the CC&Rs.

In *Intergulf*, the CC&Rs required that all disputes arising between the Association and the project developer ("Intergulf") were to be resolved by judicial reference pursuant to Code of Civil Procedure Section 638, rather than by a jury trial. In essence, Section 638 provides that a court referee may be appointed to resolve a dispute arising between parties "upon the motion of a party to a *written contract* . . . if the court finds a reference agreement exists between the parties."

On review, the Court determined that,although CC&Rs create sufficient contractual obligations with respect to relatively lesser issues such as the "operation or governance of the association or the relationships between owners and between owners and the association", CC&Rs do not suffice as a contract when the issue is the waiver of the right to trial by jury pursuant to Section 638. In forming its conclusion, the Court stated that the right to trial by jury is "fundamental" and that "it must be 'zealously guarded' in the face of a claimed waiver."

Conclusion: These two cases are troubling in many respects. In

general, they appear to follow a trend away from enforcing what the courts have, in certain circumstances, viewed as procedurally or substantively one-sided alternative dispute resolution provisions. This may be a change, at least in certain cases, from the decades old stance of encouraging alternative dispute resolution wherever possible.

Builders should consult with their legal counsel to review both their documentation and procedures in light of both of these decisions.
