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Avoiding Pitfalls to Enforce ADR, Part 1 – Don't Let Your Right to Alternative Dispute Resolution (ADR) Get Lost in the Shuffle

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There is no question that alternative dispute resolution procedures, including arbitration, judicial reference and/or mediation, allow builders, developers and general contractors to efficiently resolve homeowner disputes and avoid costly jury trials. Yet many lose their ability to compel ADR due to easily avoidable procedural mistakes. The most common of these is the tendency of some to bury the ADR provision deep in the documents. Because otherwise enforceable ADR provisions will be invalidated if not properly presented to homeowners and prospective buyers, builders must pay special attention to the manner in which they present these provisions if they want to protect their ability to compel an arbitration or judicial reference.

California courts have historically been hostile towards arbitration and reference provisions where they believe the parties to be in unequal bargaining positions, for example, a builder and a home buyer, and will invalidate them if they find them to be “unconscionable.” To be unconscionable, an agreement or contractual provision must be both substantively and procedurally defective, though not necessarily in equal parts. If both are present, less of one can be offset by more of the other.

Procedural unconscionability is a primary reason cited by courts to invalidate a builder's ADR provision. The builder's “burying” the ADR provisions “in a prolix printed form” drafted exclusively by the builder can result in a finding of “oppression” or “unfair surprise” to the home buyer. This defect is compounded when homebuyers review and sign several inches of documents during a quick closing at the escrow office. Many homeowners oppose attempts to enforce ADR with testimony that they were not given an opportunity to actually read what they were signing and/or that they felt rushed by the builder to get the paperwork completed, and courts often give great weight to this evidence.

Fortunately, procedural unconscionability can be avoided. If possible, the builder should provide prospective purchasers with the ADR materials during the first visit to a project and document that the prospective purchaser received them. The builder must then make sure that the identical materials are provided during the closing. Homeowners will not be able to argue they did not have enough time to read and understand the ADR provisions when they received them weeks or months prior to the closing.

General contractors and others working with homeowners for remodeling and related services can protect themselves by taking a similar approach. ADR provisions should be treated like the scope of work and provided to the homeowner at the beginning of the discussions. When homeowners are afforded days or weeks to review the ADR provisions it becomes much harder to credibly argue that they were surprised or that they

did not have an opportunity to ask questions.

In the world of SB-800, builders and developers can opt-out of the statutory pre-litigation procedures and implement their own procedures including arbitration or judicial reference. As to original purchasers, the builder must make this election at the time the sales agreement is executed. To bind subsequent purchasers, however, the builder must prove that they too had the builder's right to arbitration or judicial reference. The best means of doing so, although not a guarantee of success, is for the builder to record the initial sales contract containing the ADR provisions so that it will be disclosed in a later title search by the new buyer.

Builders these days are faced with a classic Catch-22. The more they disclose, the more they are accused of hiding important information in a "deluge of documents." In the case of ADR provisions, to bury them in the closing documents may be to bury them forever. A builder should not let these important rights get lost in the shuffle. The best defense to a claim of procedural unconscionability is to place the ADR provisions in the hands of the prospective buyer as early as possible and to have them acknowledge receipt. Otherwise, an efficient and economical arbitration or judicial reference may give way to a costly and inefficient trial.

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