

The Enforcement of Residential Purchase Contracts

11.01.2002

In *Pardee Construction Company v. Superior Court*, the Court of Appeals for the Fourth Appellate District found that a provision in a residential purchase contract which required any and all disputes to be heard by judicial reference and/or by a bench trial was an unconscionable and unenforceable contract of adhesion. The broad rationale employed by the Court of Appeals has far reaching impacts that cast considerable doubt on the enforcement of residential purchase contracts between buyers and developers (and the enforcement of many "form" contracts in all consumer settings).

I. THE FACTS

The case arose out of seven single family homes built in the late 1990's in Otay Mesa by Pardee. Each of the contracts between the buyers and Pardee contained a provision which required any "agreement related" claims to be heard by judicial reference. The contract further provided that in the event the judicial reference provisions were found unenforceable, any "agreement-related" claims would be tried to a court, without a jury. Each of the relevant contract provisions was printed in all capital letters and was individually initialed by each party.

The home buyers filed suit against Pardee in San Diego Superior Court alleging construction defects. Pardee sought to stay those proceedings and require resolution by judicial reference. The trial court denied Pardee's motion and found that the judicial reference provisions were adhesive and unconscionable. The appellate court upheld that finding.

II. THE OPINION

A contract of adhesion is one which is imposed by a party with superior bargaining strength and leaves the subscribing party only the opportunity to "take it or leave it." An adhesion contract is unenforceable in several circumstances, including: (1) where the contract or provision does not fall within the reasonable expectation of the adhering party; and (2) where the contract is unduly oppressive or unconscionable.

The court had little trouble concluding that the contract at issue was one of adhesion. In particular, the court noted that every one of the approximately 800 contracts in the particular master plan development contained a judicial reference provision and that none of the home buyers had stricken that provision. More troubling, the court had little difficulty concluding that the home buyers were in a "take it or leave it" position. The court seemed to place particular emphasis on the fact that the home buyers in this circumstance were first time, "entry level" purchasers and each home available for purchase was "unique." According to the court, each buyer was essentially forced to accept the terms of the purchase contract, without meaningful negotiation, and the contract was therefore adhesive.

The court also reached the conclusion that the terms of the contract were unconscionable. Unconscionability can be both procedural and substantive and the court must find that both exist in order to refuse to enforce a contract on those grounds. Procedural unconscionability focuses on whether the unequal bargaining power of the parties led to any surprise to or oppression of the weaker party. Substantive unconscionability focuses on whether the results of the contract are "shockingly one-sided."

On the procedural side, the court concluded that the relevant terms were "buried in the form contracts drafted by Pardee." The court also found that the paragraphs containing the relevant provisions, despite being in all capital letters, were difficult to read and that portions of the headings were misleading because they did not "otherwise convey anything meaningful to any entry level purchaser." For example, the Court objected to the term "JUDICIAL REFERENCE" in the heading because it did not explain what judicial reference entails. The court concluded that the "entry level" buyer would be surprised by the provisions.

With respect to substantive unconscionability, the court found that the judicial reference and bench trial provisions required the buyer to waive his or her rights to a jury trial in a regular court proceeding. The Court went on to note that Pardee had not demonstrated that the judicial reference provision would be faster or more economical to the buyer or that there was any tangible benefit to the buyer as a result of the waiver. The court found that the absence of any benefit accruing to the buyer from the judicial reference provision rendered the agreement substantively unconscionable, implicitly finding that the judicial reference provision was so one-sided in favor of Pardee that it "shocked the conscience."

As an unconscionable contract of adhesion, the court refused to enforce the judicial reference provision.

There are a number of problems with the court's decision and much of the opinion appears to be based on the desired result rather than sound legal reasoning. For example, the court found that the provisions would "surprise" the buyer even though the provisions were prominently displayed in all capital letters and required the buyer to individually initial that paragraph to indicate that the language was specifically reviewed. The court did not mention or appear to consider the fact that the paragraph was individually initialed by the buyers. Further, the court found that there was no meaningful opportunity to negotiate over the terms based solely on the fact that each of Pardee's contracts contained the judicial reference provision. This fact has little probative value in the absence of any evidence that any buyer actually attempted to negotiate those terms. The Court also reasoned that Pardee benefitted so much by the judicial reference provision that requiring the buyer to waive his or her jury trial rights was so one-sided that it shocked the conscience. This finding ignores the fact that Pardee also waived its rights to a jury trial and that there was no evidence that a judicial reference proceeding provides an inadequate forum for the buyer's grievances to be heard. In fact, as a statutorily enacted process, it is difficult to conceive how judicial reference can be considered substantively unconscionable.

The court was also convinced that the buyers had no other choice but to sign the contract "or else." In reaching this conclusion, the court repeatedly characterized each home as "unique" so that there was no alternative for these buyers other than buying the house on whatever terms the seller demanded. While there is little question that the law treats each piece of property as unique, there is no logical connection between that fact and the conclusion that all residential sales contracts are adhesive. In any home purchase there are a number of factors that have to be considered by the buyer: Is the price too high? Are the financing terms acceptable? Will the seller make the repairs deemed necessary? etc. The terms of the sales contract are just one more factor to be considered. In the end, the buyer does not have to buy that particular house or any house at all.

Ultimately, it appears that the court was interested in trying to protect lower income home buyers. The court repeatedly uses the euphemism "entry level buyers" to characterize the plaintiffs in the case. Apparently, the court was of the opinion that large scale residential developers were abusing these "entry level" buyers and that these buyers were incapable of reading and understanding the contracts they sign. Such a paternalistic approach does not bode well for the enforcement of any provisions in residential real estate purchase contracts. The buyers in the *Pardee* case could have equally used the court's reasoning to attack any other provision in the contract with which they disagreed (e.g. warranty provisions).

However, there is already some indication in more recent rulings that cast doubt on the precedential value of the *Pardee* ruling. In a case pending in Los Angeles Superior Court, *Lemer v. Pardee Construction Company, Inc.*, the court issued a ruling which declined to apply the prior *Pardee* ruling to the facts before it. In particular, the court was concerned that the *Pardee* court's opinion was based on several assumptions and conclusions which did not appear to be supported by the evidence. Ultimately, the court refused to follow the *Pardee* court's reasoning and enforced the judicial reference provision at issue in that case.

While the *Pardee* case is likely to be appealed and has already been rejected by other courts, the ruling presently represents a significant warning to all residential real estate developers, as well as any other large companies that include judicial reference provisions in "form" contracts. For now, the enforceability of such provisions may be in doubt.

© 2002, Sheppard, Mullin, Richter & Hampton LLP.

Attorneys

John A. Yacovelle

Practice Areas

Construction

Environmental

Real Estate and Land Use

Industries

Construction