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## Focus

# Case Gives Judicial-Reference Provisions Renewed Viability

By William M. Hensley

For lawyers drafting sales/purchase contracts or subdivision instruments between tract developers and residential purchasers, a vigorous debate has covered what type of alternate dispute resolution provision to include in the documents.

Some have opted for clauses making all disputes subject to binding contractual arbitration before an arbitrator, typically at the American Arbitration Association or JAMS. Others have favored making all disputes subject to judicial reference before a retired state judge, who acts as the fact trier, rendering a written decision that appellate tribunals can review fully.

Until recently, arbitration may have been the better alternative dispute resolution option, based on the hostility shown to judicial-reference clauses in *Pardee Construction Co. v. Superior Court*, 100 Cal.App.4th 1081 (4th Dist. 2002), a San Diego decision holding such a clause unenforceable in a developer-purchaser sales agreement context.

Now, the use of judicial-reference clauses has renewed viability in light of the decision in *Woodside Homes of California Inc. v. Superior Court*, 107 Cal.App.4th 723 (2003).

In the earlier *Pardee* decision, Division One of the 4th District Court of Appeal found unconscionable and unenforceable a judicial-reference clause contained in the developer's residential purchase contract for the Otay Mesa project. The provision even had a "default" feature: Claims arising from the purchase contract would be subject to a bench trial if the judicial-reference aspect was found to be unenforceable.

The 4th District affirmed a San Diego Superior Court ruling, based on a demographic analysis, that the contract was one of adhesion. It placed heavy reliance on the fact that no home purchasers had stricken the judicial-reference provision found in every one of the 800 contracts for the development. *Pardee* stressed that most buyers were "entry level," first-time purchasers, who the court characterized as being in a "take it or leave it" position.

In determining that the judicial-reference clause was procedurally unconscionable, the San Diego-based justices in *Pardee* found the clause buried in developer-drafted form contracts under a "JUDICIAL REFERENCE" heading, coupled with the confusing addition, "TRIAL BY JUDGE IN COURT OF COMPETENT JURISDICTION." The court marginalized the fact that the provision was in capital letters by finding that the clause was difficult to read.

The *Pardee* court also found the clause substantively unconscionable. Its main concern was *Pardee's* failure to demonstrate that judicial reference would be faster or more economical to the buyer or that the buyer got something in return for the jury waiver. The absence of a benefit to the buyer led the *Pardee* court to conclude that the reference clause "shocked the conscience" because of its one-sided nature.

Enter *Woodside Homes*, which distinguished and disagreed with *Pardee*, effectively creating a divergence in appellate opinion.

*Woodside Homes* dealt with a sophisticated judicial-reference clause between a developer and tract residential home buyers. The clause specified that the

referee was to be a retired judge or a senior real estate attorney. Discovery was allowed, with the referee entitled to supervise and enforce discovery rights. A confidential stenographic record of the trial was to be made but could be used in post-trial and appellate proceedings. The referee had to render a formal statement of decision. The referee's decision was appealable as a normal civil judgment. The developer did not have to participate unless all necessary parties (such as contractors and subcontractors) agreed to join in the reference. And the parties would split the referee's costs, unless ordered otherwise, and bear their respective attorney fees.

Riverside Superior Court refused to honor the judicial-reference clause on unconscionability grounds. Woodside Homes petitioned for mandate, and Division Two of the 4th District Court of Appeal issued the writ and, in the process, rejected the *Pardee* analysis in major respects.

After noting the differences from and similarities to nonjudicial arbitration, the Riverside appellate court immediately distinguished *Pardee* from the facts before it. First, the court observed that no evidence existed that the home buyers were "entry level" purchasers.

Second, it found nothing misleading about the judicial-reference clause at issue: The paragraph had to be separately initialed, the clause did conspicuously waive the right to a jury, the caption did not have the additional "TRIAL BY JUDGE" language labeled as confusing by the *Pardee* justices, and the court disagreed with *Pardee's* conclusion that the provision had to explain the mechanics of a judicial reference in detail.

The *Woodside Homes* court refused to engage in a demographic analysis like that in *Pardee*, notwithstanding that most purchasers had Hispanic surnames.

Having found little indicia of procedural unconscionability, *Woodside Homes* examined the substantive prong. It found nothing disturbing about the provisions allowing the developer to “opt out” (because *Woodside* showed that it did require contractors to participate under related agreements) or permitting the referee to be an attorney (given that attorneys are qualified referees under the Code of Civil Procedure).

The court held that there was nothing unfair about the provisions requiring the parties to bear their own fees (the governing “American rule”) or keeping proceedings secret before appeal (with the court dubbing any advantage as being “completely collateral” to overall concerns about the alternative dispute resolution option’s fairness).

*Woodside Homes* next considered whether the judicial-reference provision was substantively unconscionable. Unlike in *Pardee*, the court rejected the notion that referee costs would be onerous. The buyer failed to demonstrate that litigation expenses would be any less in a construction-defect suit likely involving discovery referees/special masters or that judicial-reference costs were unaffordable in nature.

The *Woodside Homes* panel found the jury-trial waiver valid, in stark contrast to *Pardee*’s analysis, because buyers did get something in return - the developer’s matching waiver — and nothing indicated that a neutral referee would not award compensation fairly to harmed buyers.

In reasoning sure to make defense lawyers smile, *Woodside Homes* held that it was not unconscionable for residential tract home buyers to “give up the possibility of obtaining a windfall from a jury irresponsibly generous with someone else’s money.”

Although disclaiming any intent to validate all judicial-reference clauses, *Woodside Homes* is important in upholding a judicial-reference clause used by many Southern California and national developers in their sales/purchase contracts. The decision takes on added significance in light of the state Supreme Court’s denial of a depublication request June 25.

*Woodside Homes* is no anomaly. Earlier, a Los Angeles Superior Court judge, in *Lemer v. Pardee Construction Co. Inc.*, BC 267580 (L.A. Super. Ct., decided Sept. 27, 2002), declined to follow the appellate *Pardee* decision, expressing concerns that it was based on several assumptions and conclusions not supported by the evidence.

For developer defendants, *Woodside Homes* is welcome news because judicial-reference decisions are subject to full appellate review. Code of Civil Procedure Sections 638(a), 645. Other ADR methods are much

different. For example, arbitrators are not bound to follow the law (*Moncharsh v. Heily & Blase*, 3 Cal.4th 1 (1992)), and their decisions are immune from review in the absence of bias or fraud (Code of Civil Procedure Section 1286.2).

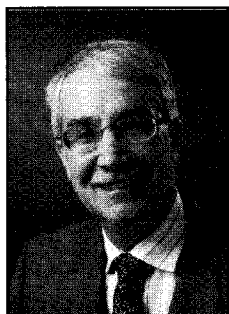
Also, arbitration provisions cannot attempt validly to displace the constricted fraud/bias review standards with normal appellate review, whether under California law or several Federal Arbitration Act decisions. See *Crowell v. Downey Community Hosp. Found.*, 95 Cal.App.4th 730 (2nd Dist. 2002); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001); *UHC Mgmt. v. Computer Sciences Corp.*, 148 F.3d 992 (8th Cir. 1998); but see *Bargenquast v. Nakano Foods Inc.*, 243 F.Supp.2d 772 (N.D. Ill. 2002) (noting contrary view under Federal Arbitration Act but siding with *Bowen*).

It will be interesting to see how other appellate districts approach the *Pardee/Woodside Homes* opinion split as the jurisprudence evolves in this area of vital importance to developers and mass home buyers alike.

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