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***D. R. Horton, Inc. v. Green*, 120 Nev. Adv. Op. 63, 96 P.3d 1159 (Nev. 2004)¹**

CONTRACTS – UNCONSCIONABILITY – ARBITRATION CLAUSE

Summary

Appeal from a district court order denying a motion to compel arbitration.

Disposition/Outcome

Affirmed. A contractual arbitration provision is procedurally and substantively unconscionable when it is inconspicuous, one-sided, and fails to advise the homebuyer that upon signing, significant rights under Nevada law are waived.

Factual and Procedural History

Real estate developer D.R. Horton entered into home purchase agreements with Michael Green, John Velickoff, and Tracy Velickoff (hereinafter “Homebuyers”). The purchase agreements contained a mandatory binding arbitration provision.²

The two page agreement was printed in small font. The front page contained the purchase price, financial information, and signature lines. At the bottom, in capital and bold letters, a clause read³:

PARAGRAPHS 10 THROUGH 27 CONSTITUTE A PART OF THIS CONTRACT

On the last page, among other things, there was a limited warranty clause and the arbitration provision. The font size used on the last page was even smaller than that utilized on the front page of the agreement. The arbitration provision read:

11. THIS CONTRACT IS SUBJECT TO THE NEVADA ARBITRATION RULES GOVERNED UNDER NEVADA REVISED STATUTE CHAPTER 38 AND THE FEDERAL ARBITRATION ACT.

Buyer and Seller agree that any disputes or claims between the parties, whether arising from a tort, this Contract, any breach of this Contract or in any way related to this transaction, including but not limited to claims or disputes arising under the terms of the express limited warranty referenced in Paragraph 10 of this Contract, shall be settled by binding arbitration under the direction and procedures established by the American Arbitration Association “Construction Industry Arbitration Rules” except as specifically modified herein or dictated by applicable statutes including Nevada Revised Statute Chapter 38 and/or the Federal Arbitration Act. If Buyer does not seek arbitration prior to initiating any legal action, Buyer agrees that Seller shall be entitled to liquidated damages in the amount of ten thousand dollars (\$10,000.00). Any dispute arising from this Contract shall be submitted for determination to a board of three (3) arbitrators to be selected for each such controversy. The decision of the arbitrators shall be in writing and signed by such arbitrators, or a majority of them, and shall be final and binding among the parties. Each party shall bear the fees and expenses of counsel, witnesses, and employees of such party, and any other costs and expenses

¹ By Hilary Barrett Muckleroy

² The homebuyers each signed separate contracts, although each contract contained an identical arbitration clause.

³ For purposes of illustration, similar font size to that used in the contract has been duplicated here.

incurred for the benefit of such party. All other fees and expenses shall be divided equally between Buyer and Seller.

Nothing other than the capitalized paragraph title drew attention to the arbitration provision.

Green testified that he only read the first page of the agreement, because the second page was “all fine print.” Horton’s agent told Green it was a standard contract. The Velickoffs testified that they read both pages of the agreement, including the arbitration clause, but did not understand that the provision constituted a waiver of their right to a jury trial or affected their rights to a construction defect claim under NRS Chapter 40.

In 2000, Homebuyers notified Horton of their intent to bring construction defect claims and the matter continued to arbitration pursuant to NRS 40.680. The mediator concluded that the mediation was unsuccessful because Horton proceeded in bad faith.

On September 14, 2001, Horton sought arbitration of the claims. Homebuyers answered Horton’s demand for arbitration and requested punitive damages in addition to compensatory damages for the defects. While the parties were disputing a list of potential arbitrators, Homebuyers filed suit in district court seeking a declaratory judgment that the arbitration provision was unenforceable.

After a hearing, the district court denied Horton’s motion to compel arbitration, ruling that the clause was adhesive and did not meet Nevada’s standards regarding jury trial waivers.⁴ The district court also held that the clause was procedurally and substantively unconscionable because it operated to waive the right to a jury trial without mentioning the right and failed to inform homebuyers of the costs associated with arbitration and the difference in arbitration fees and filing fees of suits foiled under Chapter 40.

The district court refused to enforce the arbitration clause on the grounds that absent these disclosures, a homebuyer could not give informed consent.

Discussion

Under NRS 38.247(1)(a), a denial of a motion to compel arbitration is directly appealable. The party seeking to enforce the clause bears the burden of demonstrating that the clause is valid.⁵

Contractual unconscionability involves mixed questions of law and fact.⁶ The trial court’s factual findings are accepted upon review is supported by substantial

⁴ The Supreme Court of Nevada noted that the district court erred in analyzing the clause as a waiver of a jury trial, as the clause contained no such provision and Nevada case law regarding the enforceability of a jury trial waiver is inapplicable to the enforceability of an arbitration clause.

⁵ *Obstetrics & Gynecologists v. Pepper*, 101 Nev. 105, 108, 693 P.2d 1259, 1261 (1985).

⁶ *Patterson v. ITT Consumer Fin. Corp.*, 18 Cal. Rptr. 2d 563, 565 (Cal. Ct. App. 1993).

evidence.⁷ Application of a trial court's factual findings to the issue of whether a contractual provision is unconscionable is a question of law subject to de novo review.⁸

Unconscionability

There is a strong public policy favoring arbitration because arbitration avoids the higher costs and longer time periods of litigation.⁹ However, courts may invalidate unconscionable arbitration provisions.¹⁰ Generally, in order for a court to invalidate an arbitration provision, procedural and substantive unconscionability must be present.¹¹ However, when the procedural unconscionability is great, less evidence of substantive unconscionability is necessary.¹²

When the party lacks a meaningful opportunity to agree to the clause terms either because of unequal bargaining power¹³ or because the clause and its effects are not easily ascertainable upon review of the contract, a clause is procedurally unconscionable.¹⁴ This usually involves the use of fine print and complicated, incomplete, or misleading language which fails to inform a reasonable person of the contract's consequences.¹⁵

The district court found that the Homebuyers had unequal bargaining power and, therefore, the agreement was an adhesion contract. The supreme court held that this determination was not supported by substantial evidence because the record showed that it was possible to negotiate for deletion of this provision.

The district court also found that the agreement was procedurally deficient because failed to indicate that by agreeing to arbitration, the Homebuyers would give up substantial rights under Nevada law. Additionally, the court found that the clause was in fine print, undistinguishable from other provisions, and its significance was downplayed.

The supreme court agreed with the district court that the clause was difficult to read and that nothing drew attention to its presence. Even the termite and drainage provisions were capitalized, yet the arbitration provision was not.

The failure to highlight the arbitration provision, coupled with the representations of Horton's agent that the agreements were standard contracts were key elements in the district court's findings of procedural unconscionability.

⁷ Lovey v. Regence Blueshield of Idaho, 72 P.2d 877, 881 (Idaho 2003).

⁸ *Id.*

⁹ Burch v. Dist. Ct., 118 Nev. 438, 442, 49 P.3d 647, 650 (2002).

¹⁰ *Id.*

¹¹ *Id.*

¹² Armendariz v. Foundation Health Psychcare, 6 P.3d 669, 690 (Cal. 2000).

¹³ As is the case in adhesion contracts.

¹⁴ *Id.* at 443-44, 49 P.3d at 650; Circuit City Stores, Inc. v. Adams, 279 F.3d 889, 893 (9th Cir.), *cert. denied*, 535 U.S. 1112 (2002).

¹⁵ American Airlines, Inc. v. Wolens, 513 U.S. 219, 249 (1995) (O'Connor, J., concurring).

Further, even if the Homebuyers noticed and read the arbitration provision, they would not be put on notice that they were waiving important rights under Nevada law. In addition to the right to a jury trial, Nevada law provides for the recovery of attorney's fees and costs in a construction defect claim.

Horton did not have a duty to explain in detail each and every consequence of the arbitration agreement. However, to be enforceable, the arbitration clause must at least be conspicuous and clearly put a purchaser on notice that s/he is waiving important rights under Nevada law. Therefore, the district court did not err in finding the arbitration clause unenforceable.

Turning to the issue of substantive unconscionability, there were two provisions of the agreement implicating substantive unconscionability. First, the \$10,000 penalty for refusing to arbitrate. Second, the requirement that each party pay equal shares of the cost of the arbitration.

The Ninth Circuit has held that “[w]here an arbitration agreement is concerned, the agreement is unconscionable unless the arbitration remedy contains a ‘modicum of bilaterality.’”¹⁶

Here, the arbitration provision was one-sided because it imposed a penalty on Homebuyers if they refused arbitration, but imposed no such requirement on Horton. While this one-sidedness is not overwhelming, it is sufficient to establish substantive unconscionability. Therefore, the district court properly determined that the arbitration provision was substantively unconscionable.

Conclusion

A contractual arbitration provision is procedurally and substantively unconscionable when it is inconspicuous, one-sided, and fails to advise the homebuyer that upon signing, significant rights under Nevada law are waived.

¹⁶ *Ting v. AT&T*, 319 F.3d 1126 (9th Cir.), *cert. denied*, 124 S. Ct. 53 (2003) (quoting *Armendariz*) (applying California law).