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## U.S. Home Corp. v. The Michael Ballesteros Trust, 134 Nev. Adv. Op. 25 (April 1, 2018)

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## CONTRACT LAW: ARBITRATION AGREEMENTS

### **Summary**

The Court held that where an underlying transaction involves interstate commerce, the FAA (Federal Arbitration Act) preempts state unconscionability doctrine from disfavoring arbitration.

### **Background**

Twelve Southern Nevada homeowners brought a construction defect action against U.S. Homes. The homes were subject to CC&Rs in a common-interest community, which contained an arbitration clause. The district court denied U.S. Homes motion to compel arbitration after finding that the transaction did not affect interstate commerce. On appeal, the Nevada Supreme Court overruled the district court's decision. The Court found the transaction did impact interstate commerce, and that the FAA preempted any state law actions to disfavor arbitration.

### **Discussion**

#### I.

U.S. Home Corporation contracted directly to build and sell homes in a Southern Nevada common-interest community. A construction defect action arose from twelve single family homes. The CC&Rs contained an arbitration section that required any disputes between the owner and builder to be resolved through arbitration. All of the homeowners sent U.S. Homes construction defect pre-litigation notices between August 2013 and February 2015. U.S. Homes filed to compel arbitration after the homeowners filed a construction defect claim in district court. The district court held the FAA does not apply because the underlying transaction, building and purchasing/selling homes, did not involve interstate commerce. The district court also held the agreement unconscionable under state law. U.S. Homes appealed the district court's action.

#### II.

The homeowners argued that CC&Rs are covenants that run with the land, as opposed to contracts that are binding on the individuals. Conversely, U.S. Homes argued that the homeowners agreed to the terms of the CC&Rs, including the arbitration clause when they purchased the property. So, the Court initially considered if the CC&Rs were even binding on the homeowners. The Court looked to the "nature and purpose" of CC&Rs to decide whether arbitration agreements are allowable within.

Nevada adopted the Uniform Arbitration Act of 2000, which provides that arbitration agreements are valid, enforceable, and irrevocable unless law and equity grounds allow its revocation. Moreover, arbitration agreements can appear in traditional two-party contracts or in

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written records that do not require a signature. The Court relied on various case law to support the proposition that CC&Rs create contractual obligations and that purchasing property in a common interest community manifests an owner's assent to the CC&Rs. Thus, arbitration agreements contained in CC&Rs can trigger the FAA.

Generally, the FAA does not allow judicial invalidation of an arbitration agreements based on state law requirements, unless applicable to other contractual clauses. For example, the FAA preempts a court from only invalidating the arbitration clause in a declaration of CC&Rs. However, unconscionability may serve as a valid defense to an arbitration agreement.

### III.

Next, the Court analyzed whether the FAA applied to the arbitration agreement. The homeowners argued the FAA did not apply because the purchase and sale of homes is an intrastate transaction, with no effect on interstate commerce.

#### A.

The FAA applies to contracts that transactions involving interstate commerce. The Court held that "involvement" in interstate commerce is very broad, and includes transactions that "affect" interstate commerce. Further, transactions could be considered to impact interstate commerce if they are transactions that Congress could regulate through the Commerce Clause.

#### B.

The Court rejected the homeowners' argument that the underlying transaction was only a matter of intrastate commerce and that real estate is traditionally of local concern. The Court pointed to the CC&Rs which allow the homeowners to develop, market, and sell their homes. The Court also highlighted the fact that the various out-of-state businesses provided services to construct the homes, which was relevant for the construction defect claims. Therefore, the underlying transaction did affect interstate commerce and the FAA applies.

### IV.

The FAA applies since the CC&Rs involve transactions that impact interstate commerce. The United States Supreme Court held that the FAA preempts state laws that disfavor arbitration. Here, the district court used state law to invalidate the CC&Rs on grounds of unconscionability. Further, the district court did not even consider the FAA because it erroneously found the housing transaction only impacted intrastate commerce.

#### A.

The Court considered whether the FAA preempts invalidation of the arbitration agreement on unconscionability grounds. The FAA allows states to regulate contracts and arbitration clauses using traditional contract principles. The FAA also allows this to include fraud, duress, and unconscionability. However, states may not analyze the arbitration clause differently than the rest

of the contract. In other words, arbitration clauses must be placed “on the same footing” as other parts of the contract.

There are two categories under which the FAA can preempt state law. First, the FAA preempts state laws that do not allow arbitration. Second, the FAA preempts traditionally applicable doctrines that have been applied in such a way that disfavors arbitration. Here, unconscionability is a generally accepted doctrine, but the district court applied it to render an arbitration agreement unenforceable.

## B.

To invalidate a contract on unconscionability grounds, Nevada law requires a showing of both procedural and substantive unconscionability. The Court rejected the district court’s ruling that the agreement was procedurally unconscionable, by finding arbitration section was conspicuous because it did not use fine print or any other tactics to make the section less noticeable. Requiring an arbitration agreement to be more conspicuous and have stricter requirements than other sections of the contract is not allowed under the FAA. The Court also found that requiring arbitration to take place within 180 days after the appointment of the arbitrator does not constitute procedural unconscionability, because arbitration is meant to streamline the litigation process, which includes making the process cheaper and faster. The Court did not consider substantive unconscionability, since the FAA controls and preempts both of these procedurally unconscionability concerns.

## V.

CC&Rs are not considered traditional two-party contracts. However, CC&Rs have the power to legally bind parties subject to them. Thus, both the homeowners and builders were contractually obligated to arbitrate any construction defect claims. The CC&Rs involved commerce, which is governed by the FAA. Therefore, attempts to disfavor the arbitration agreement and render it unconscionable are preempted by the FAA.

## **Conclusion**

The FAA preempts state law from disfavoring arbitration agreements in transactions that have an underlying interest in interstate commerce.