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Will Construction Defect Cases Involving Homeowners Associations Be Subject To Binding Arbitration After All? California Supreme Court Grants Review Of Two Lower Court Of Appeal Decisions Which Barred Enforcement Of Binding Arbitration Clauses Contained In Covenants, Conditions and Restrictions Prepared By The Developer....

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For more than a decade, the California Courts have grappled with the question of whether, in the context of a construction defect lawsuit, a developer of a multi-unit condominium development can require a homeowners association to arbitrate its claims based on a binding arbitration clause contained in the Covenants, Conditions and Restrictions drafted by the developer. Based on the California Supreme Court's recent grant of review in Pinnacle Museum Tower Association v. Pinnacle Market Development (US), LLC (2010) 187 Cal.App.4th 24 (review granted November 10, 2010) ("Pinnacle Museum") and Villa Vicenza Homeowners Association v. Nobel Court Development, LLC (2011) 191 Cal.App.4th 963 (review granted April 20, 2011) ("Villa Vicenza"), it now appears that some clarity will be achieved, and likely in favor of developers.

The issue is relatively simple.

Developers of condominium projects, loathe to litigate construction defect cases in the Court system, have attempted, with little success, to impose binding arbitration for construction defect cases on homeowners associations by including binding arbitration clauses in the Covenants, Conditions and Restrictions for the development. The basic argument in favor of binding arbitration is that the Federal Arbitration Act, 9 U.S.C. section 1, et seq., makes binding arbitration clauses enforceable and indeed favors arbitration. Moreover, where an arbitration agreement is covered by the Federal Arbitration Act, the Federal Arbitration Act preempts any conflicting state law. See, Shepard v. Edward Mackay Enterprises, Inc. (2007) 148 Cal.App.4th 1092, 1097[1] and Citizens Bank v. Alafabco (2003) 539 U.S. 52, 55-58. Since the construction of a common interest development typically involves materials and products manufactured in

[1] The California Courts have already ruled that an individual homeowner which knowingly executes a binding arbitration contract in a residential purchase agreement can be subject to binding arbitration. Shepard v. Edward Mackay Enterprises, Inc. (2007) 148 Cal.App.4th 1092, 1097.

other states (i.e. involves interstate commerce), the Federal Arbitration Act would likely apply with respect to any common interest development construction defect dispute.

The question which the California Courts have grappled with recently, however, is whether, applying California law, a homeowners association can be considered to have entered into an arbitration contract in the first place (and knowingly waive its right to a jury trial) when it was the developer - not the homeowners association, which drafted the Covenants, Conditions and Restrictions.

Prior to 2010, the Court of Appeal in two cases ruled that arbitration clauses, drafted by the developer, were unenforceable. In 2000, the Fourth District Court of Appeal in Villa Milano Homeowners Association v. Il Davorge (2000) 85 Cal.App.4th 85 ("Villa Milano") appeared to find that Covenants, Conditions and Restrictions were a permissible means of obtaining a jury waiver but ruled the arbitration clause in that case to be unenforceable on the basis of its being unconscionable. In 2008, that same Court ruled in Treo at Kettner Homeowners Association v. Superior Court (2008) 166 Cal.App.4th 1055 ("Treo") that the inclusion of a judicial reference pursuant to Code of Civil Procedure section 638 in the subject Covenants, Conditions and Restrictions was unenforceable in light of California public policy favoring rights to jury trial. Review was denied by the California Supreme Court in both Villa Milano and in Treo.

Last year, the Court of Appeal, Fourth District, again barred the enforcement of binding arbitration clauses in Pinnacle Museum and Villa Vicenza.

In Pinnacle Museum, the California Court of Appeal issued an opinion on July 30, 2010 finding that a homeowners association which had filed an action on its own behalf, and as a representative of its members, could not be compelled to arbitrate construction defect claims where the provision requiring binding arbitration in the Covenants, Conditions and Restrictions could not be changed without the consent of the developer. However, the California Supreme Court granted review of Pinnacle Museum on November 10, 2010.

In Villa Vicenza (a condominium conversion case), the same California Court of Appeal again ruled that, while both federal and state law favor the enforcement of arbitration agreements and the connection between the Condominium Conversion Act and interstate commerce was sufficient to support the application of the Federal Arbitration Act, the arbitration provision inserted by the developer into the Covenants, Conditions and Restrictions did

not represent a binding agreement on the part of the homeowners association to arbitrate construction defect claims against the developer because the homeowners association did not enter into an arbitration agreement but instead had it imposed on it without any input. The Court also acknowledged case law which holds that Civil Code section 1354 treats Covenants, Conditions and Restrictions as equitable servitudes, but found those cases to only apply to disputes between homeowners or homeowners associations and was not intended to provide the developer a means to impose a continued and irrevocable contractual benefit to the developer. However, just as with Pinnacle Museum, on April 20, 2011 the California Supreme Court also granted review of the Villa Vicenza decision.

The California Supreme Court's grant of review in both Pinnacle Museum and Villa Vicenza is significant. There is little question that the Federal Arbitration Act will be deemed to apply in both cases but it is expected that the California Supreme Court will determine whether, for purposes of state law, a homeowners association - via Covenants, Conditions and Restrictions, can be deemed to have entered into a binding arbitration contract when its members, not affiliated with the developer, had no opportunity to negotiate its terms. At this point, the authors anticipate that, because the prospective members of the homeowners associations will be shown to have had the opportunity to review the Covenants, Conditions and Restrictions prior to purchase, the Covenants, Conditions and Restrictions will be found to be enforceable contracts against the homeowners associations under California law.

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