Los Angeles | Daily Journal TUESDAY, AUGUST 10, 2010

Mixed Decisions on Construction Defects

By Jason W. Armstrong
Daily Journal Staff Writer

Do mandatory arbitration provisions in a residential development's covenants, conditions and restrictions constitute a legal agreement with homeowners that bars them from trying to take their construction-defect claims to trial?

That's a hotly contested dispute that California courts are wrestling with, and one that could ultimately have a big impact on how developers draft the so-called CC&Rs that residents sign with a homeowners association when they get the deeds to their properties.

"There is a difference of opinion by the circuits that may have to be addressed by the state Supreme Court," said Paul N. Dubrasich, a partner with Cox, Castle & Nicholson in San Francisco who handles residential and commercial real estate development issues and has tracked the litigation.

Late last month, a San Diego-based panel of justices with the 4th District Court of Appeal published an opinion saying an arbitration requirement in the CC&R's for the Pinnacle Museum Tower condominium development in downtown San Diego didn't constitute an "agreement" sufficient to waive the legal right to a jury trial for construction-defect allegations waged by the project's homeowner's association, and the justices found the provision "unconscionable."

"Based on the application of fundamental contract formulation principles, we fail to see how the Association could have agreed to waive its constitutional right to a jury trial, because, for all intents and purposes, Pinnacle was the only party to the 'agreement,' and there was no independent homeowners association when Pinnacle recorded the CC&Rs," Justice James A. McIntyre, joined by Acting Presiding Justice Gilbert P. Nares, wrote July 30.

Justice Terry Byron O'Roarke dissented.

Kathleen Carpenter.

He referred to a 2000 state appellate opinion that said individual condominium unit owners "are deemed to ... agree to be bound by" written and recorded CC&Rs.

"The provision requiring Pinnacle's written consent for modification of the arbitration agreement does nothing more than apply a general principle of California contract law," O'Roarke wrote. *Pinnacle Museum Tower Association v. Pinnacle Market Development,* D055422.

In another sign of judicial wrangling on the issue, a different panel of the same court also overturned a similar arbitration provision in a different case in May, but ended up de-publishing it. *Villa Vicenza Homeowners Association v. Nobel Court Development, LLC,* D054550. In an opposite finding in March in another suit, the 2nd District Court of Appeal upheld a CC&R arbitration clause in a mixed-use downtown Los Angeles project called 9th Street Lofts, saying that although it was "one-sided," it wasn't "substantively unconscionable." *Van Parys v. 9th Street Market Lofts, LLC,* B213954.

"There is no clear guidance by the courts at this point," said Kathleen Carpenter, a partner at Luce Forward Hamilton & Scripps in San Francisco whose practice includes handling complex construction and real estate disputes.

Homeowners' associations have long been governed by developer-drafted CC&Rs. The documents, which homeowners and associations agree to as part of the deeds to their properties, dictate rules ranging from parking and pet ownership policies to legal parameters including the arbitration requirement.

While the agreements are common, Carpenter, who has closely followed the issue, said the fight over resolving construction-defect cases out of court has intensified in the wake of SB 800, the state's so-called "Right to Repair" law.

SB 800, enacted in 2003, gave builders the chance to fix defects in their products before being sued if they complied with a lengthy list of pre-litigation filings and procedures. It was crafted as a compromise between developers and builders and plaintiffs' attorneys to more quickly resolve defect claims while cutting back on the number of lawsuits.

Court cases invalidating CC&R arbitration provisions could lead to more construction defect lawsuits, which Carpenter said would counter the litigation prevention goals of SB 800.

"There may be a flood of people attempting to get back into the old system, which the Legislature tried to [oppose] in SB 800," she said.

Dubrasich said the debate over arbitration agreements has made him and his colleagues more careful in laying out documents.

"We're ever more mindful of how we're drafting our purchase agreements and CC&Rs for subdivision projects," he said.

jason_armstrong@dailyjournal.com