FOURTH DISTRICT CONFIRMS IT AGAIN: CC&RS ARE NOT THE PATH TO ARBITRATION OF CONSTRUCTION DISPUTES

The California Fourth District Court of Appeal has, once again, made it more difficult for residential developers to require homeowners associations to use alternative dispute resolution for settling construction deficiency claims. In *Villa Vicenza Homeowners Association v. Nobel Court Development,* the Court held that a clause in condominium CC&Rs requiring that defective construction claims against the declarant be resolved by arbitration under the Federal Arbitration Act did not meet the requirements of a contract and could not be enforced.

The developer of a condominium project, Nobel, recorded a declaration of covenants, conditions and restrictions (CC&Rs) that required the homeowners association (HOA) to arbitrate any construction defect claim it may have had against Nobel. The HOA owned common area, which the owners claimed to contain construction defects. The owners brought a derivative action on behalf of the HOA against Nobel, claiming that Nobel failed to provide sufficient reserves in the HOA's budget to repair the construction defects. The HOA also sued Nobel for breach of implied warranty, strict liability, negligence, and, as a "third party beneficiary," breach implied and express warranties given by Nobel to the owners. Nobel filed a motion to compel arbitration under the CC&Rs. The trial court denied the motion (except for express warranty claims). The Fourth District Court of Appeal affirmed the trial court's ruling.

The Court of Appeal recognized that federal and state law favor the enforcement of arbitration agreements. It also acknowledged that the Federal Arbitration Act preempts California laws that would otherwise make arbitration agreements concerning defective construction unenforceable. It held, however, that the Federal Arbitration Act may only be invoked where there is an actual agreement to arbitrate. In the case of CC&Rs, which are signed solely by the developer/declarant and not by the individual homeowners, it held there can be no valid agreement to arbitrate in the first place. Although CC&Rs have been considered, under both common and statutory law, to be "equitable servitudes" that run with the land and bind each owner of property covered, the court concluded that equitable servitudes are designed only to govern the relationships of the *present and future owners*. According to the court, they are not intended to be enforced by persons other than owners within the development, and especially not by the developer who drafted the CC&Rs and may no longer even own a unit. Relying somewhat on the fact that arbitration provisions are, in effect, waivers of the fundamental right to a jury trial, the court determined that arbitration provisions must be entered into "knowingly and voluntarily," which cannot be the case where CC&Rs are signed only by the "declarant."

The *Villa Vicenza* decision is the second time the Fourth District has called into question the enforceability of arbitration provisions in CC&R purported benefitting solely the declarant (see, for instance, T*reo @ Kettner Homeowners Assn. v. Superior Court* (2008)). It is by no means new law. Conflicting decisions in other Districts, however, may give the California Supreme Court justification to review the holding in *Villa Vicenta*, and we will need to await the outcome of any petition for Supreme Court review of the case.

As for now, the path to enforceable, mandatory arbitration or judicial reference (sometimes called "alternative dispute resolution" or "ADR") of construction-related disputes is clearly not through CC&Rs. To have a chance of enforceability, ADR should be addressed in individual agreements between the home builder and its home/condominium purchaser. In the case of common area owned by an HOA, however, agreements with individual purchasers may still not be enough, because the HOA is generally a separate legal entity and individual unit buyers cannot sign contracts on its behalf.

(continued on back)

Los Angeles
2049 Century Park East, 28th Floor
Los Angeles, CA 90067
P (310) 277-4222
F (310) 277-7889

Orange County
19800 MacArthur Blvd., Suite 500
Irvine, CA 92612
P (949) 476-2111
F (949) 476-0256

San Francisco
555 California Street, 10th Floor
San Francisco, CA 94104
P (415) 392-4200
F (415) 392-4250

So, are HOA/developer arbitration provisions in CC&Rs completely without use or benefit to home builders? Not necessarily. CC&Rs or other recorded instruments (such as a separate ADR Declaration), coupled with valid ADR agreements between the home builder and its purchasers, can help to ensure that ADR requirements run with the land as to future owners. Even then, there is no guaranty of the enforceability of ADR, considering the recent trend of the case law. One thing we do know is that there are no simple solutions, and no approach to mandatory ADR for construction disputes is necessarily fool proof.

The *Villa Vicenta* case and others like it underscore how critical it is for both condominium and single family residential developers to work with competent risk management and project document professionals, who understand the recent case law and can develop and design project, CC&R and consumer sale structures that provide the greatest advantage to homebuilders within the current parameters of the law.

For more information about the Villa Vicenta case, about CC&Rs for condominiums, planned developments and master planned communities, and about state-of-the-art risk management strategies for homebuilders, please contact:

Paul N. Dubrasich at 415.262.5120 or pdubrasich@coxcastle.com
Jeffrey D. Masters at 310.284.2239 or jmasters@coxcastle.com
Sandra C. Stewart at 310.284.2250 or sstewart@coxcastle.com
Scott D. Turner at 949.260.4627 or sturner@coxcastle.com
Camellia Schuk at 949.260.4623 or cschuk@coxcastle.com