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Law in Hand

PINNACLE DECISION IN CALIFORNIA

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In a stunning decision by the California Supreme Court, homeowners associations must now take their construction defect claims to an arbitrator rather than the Superior Court when the Covenants, Conditions, and Restrictions ("CC&Rs") contain a valid arbitration clause. The case seeks to clarify some long-standing disputes between developers and homeowners over whether a homeowners association is subject to an arbitration provision contained in the governing documents. Although the way the Supreme Court arrived at its decision has stirred some controversy, the result is that California courts will apparently see far less construction defect litigation as the parties turn to the arbitration provisions contained in the governing documents.

The Issue – Isn't that Unconscionable?

In *Pinnacle Museum Tower Association v. Pinnacle Market Development*, LLC, 55 Cal.4th 223, the California Supreme Court considered the appeal of a developer who argued the CC&Rs required that the construction defect dispute brought by the homeowners association be resolved at arbitration rather than before a jury. At first glance, the request seemed reasonable – if a person signs an agreement to arbitrate disputes with another party, and knows he is voluntarily giving up his right to a jury trial, then arbitration can actually be a faster and less costly way to resolve the dispute. However, at the time the CC&Rs were drafted and recorded, the homeowners association was not yet in existence and no one had purchased any condominium units in the development. Since the association was not in existence and no one had purchased a unit, how could either the association or the eventual unit owners be deemed to "agree" to waive their right to litigate? Stated another way, how could either the association or eventual unit owners' contract with the developer if the developer wrote and recorded the CC&Rs prior to the existence of the association or the purchase of any units?

Background Facts

In this case, the Pinnacle Market Development (the Developer) built a mixed use high-rise residential and commercial common interest community in San Diego. As required by the Davis-Stirling Act (California Civil Code §§ 4000 - 6150, *et seq*.), the Developer drafted and recorded the CC&Rs governing the use and operation of the common interest development. The CC&Rs provided for the creation of the Pinnacle Museum Tower Association (Association) to serve as the homeowners association responsible for managing and maintaining the property. Additionally, pursuant to Article XVIII of the CC&Rs, the Association and each unit owner "agreed" to, among other things, have any construction dispute decided by arbitration and to give up any rights to have the dispute litigated in a court or jury trial.

Sometime later, the Association filed a Complaint in Superior Court against the Developer alleging construction defects causing damage to the development. The Developer, citing Article XVIII of the CC&Rs, moved to compel arbitration. The San Diego Superior Court determined that the Federal Arbitration Act was applicable and that Article XVIII embodied the agreement to arbitrate, but found the agreement marked by unconscionability and denied the Developer's motion to compel arbitration. Unconscionability is a defense against the enforcement of a contract based on allegations the contract is grossly unfair to one party.

The Court of Appeal affirmed the Superior Court's decision finding the arbitration clause in Article XVIII did not constitute an agreement sufficient to waive the Association's constitutional right to litigate and force it to arbitrate. The Court of Appeal specifically noted that "for all intents and purposes [the Developer] was the only party to the 'agreement,' and there was no independent homeowners association when [the Developer] recorded the CC&Rs." The Developer later petitioned the California Supreme Court for review.

The California Supreme Court's Decision

The California Supreme Court reversed the judgment of the Court of Appeal and found the Court of Appeal's reasoning unpersuasive in light of various statutory and contractual principals. Noting that California courts recognize CC&Rs as contracts, the Supreme Court stated that CC&Rs are a "primary means of achieving the stability and predictability so essential to the success of a shared ownership housing development." Further, that stability and predictability are promoted by the presumption of reasonableness which requires the CC&Rs be enforced unless they are arbitrary, violate public policy, or impose a burden of use on the land which far outweighs any benefit. The Court also noted that the Davis-Stirling Act contemplated alternative dispute resolution such as arbitration as a prerequisite to construction defect litigation.

In addressing whether the CC&Rs were unenforceable due to unconscionablity, the Supreme Court specifically noted that the CC&Rs "were drafted and recorded before the sale of any unit and without input from the Association [as] a circumstance dictated by . . . the Davis-Stirling Act." As such, the Developer's compliance with the Davis-Stirling Act was sufficient. Further, the Supreme Court noted that the California Department of Real Estate reviewed and approved the CC&Rs before issuing the required public report for the project, that no aspect of Article XVIII was overly harsh or so one-side that it shocked the conscience, and that other provisions in

Article XVIII were facially neutral. Consequently, the Supreme Court found no unconscionability, reversed the judgment of the Court of Appeal, and found Article XVIII's requirement that the Association arbitrate rather than litigate was valid.

Conclusion

Noting that "arbitration benefits both the developer and the entire common interest community by providing a speedy and relatively inexpensive means to address allegations of defect damage to the common areas and other property interests," the Supreme Court has demonstrated a strong policy favoring arbitration.

If you think you have potential construction defects, contact Burdman & Ward for a free, no obligation inspection with a licensed contractor.

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