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A Straight Path to the Courthouse Door: Court of Appeal Rules That Binding Arbitration Clause Contained In Sales Contracts And Covenants, Conditions and Restrictions For Common Interest Developments Are Not Binding On Homeowners Association (Or Members Of The Homeowners Association) With Respect to Construction Defect Lawsuits

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In an interesting twist on the arbitrability of disputes in construction defect cases, a developer, Pinnacle Market Development (US) LLC ("Pinnacle"), recently attempted to compel binding arbitration, and thereby thwart a court action of a construction defect case, on the basis that the individual owner sales contracts and Covenants, Conditions and Restrictions ("CC&R's") for the common interest development, which were prepared by the developer, would be binding with respect to any construction defect case. In an opinion published on July 30, 2010, Pinnacle Museum Tower Association v. Pinnacle Market Development (US), LLC 187 Cal.App.4th 24 ("Pinnacle Case"), the California Court of Appeal, 4<sup>th</sup> Appellate District, ruled that the arbitration provision, which could not be changed by the homeowners association without the written consent of the developer, did not constitute an agreement sufficient to waive the constitutional right to jury trial for construction defect claims brought by the homeowners association. The same Court further ruled that the mandatory arbitration provisions in the individual owners' sales contracts were unconscionable.

The Pinnacle Case arose from the construction and sale of condominiums in the downtown San Diego area known as the Pinnacle Museum Tower Condominium Project. The developer recorded CC&R's forming the Pinnacle Museum Tower Association, a California nonprofit mutual benefit corporation, to manage and repair the Project's common areas.

The second page of the CC&Rs provides, in capital letters, that Article 18 of the CC&Rs contains a mandatory procedure for the resolution of construction defect disputes that includes the waiver of the right to jury trial. Article 18 of the CC&Rs in turn contains an arbitration provision reciting in capital letters that Pinnacle, the condominium owners and the Association agree to resolve any construction disputes through binding arbitration in accordance with the Federal Arbitration Act, see, 9 U.S.C. § 1, et seq. and the California Arbitration Act. See, California Code of Civil Procedure § 1280, et seq.

In addition, in selling the individual condominiums, Pinnacle employed a standard purchase and sale agreement that recited, on the first page, that the buyer agreed to comply with the CC&Rs by accepting a grant deed to the condominium. Page 8 of that document also contained a section pertaining to dispute notification, resolution procedures and waivers. The section required the initials of the buyers and seller and set forth that the buyers were waiving their respective rights to pursue any dispute in the manner other than as provided in the CC&Rs.

In the wake of this scheme, the Association filed suit alleging construction defects. After filing suit, Pinnacle petitioned to compel arbitration. The Trial Court denied the petition and Pinnacle appealed.

The Court of Appeal affirmed.

In its decision, the Court of Appeal essentially made three findings. First, citing Treo @ Kettner's Homeowners Association v. Superior Court (2008) 166 Cal. App.4th 1055, the Court noted that a waiver of jury trial in CC&Rs was not enforceable as it did not provide meaningful notice and actual reflection. In that regard, the Court of Appeal noted that, while the CC&Rs for the subject development provided that - by accepting a grant deed for any portion of the Association property, the individual purchasers had waived a right to jury trial, there was in effect no decision or choice on the part of the Association as it had no option but to accept the property that Pinnacle deeded to it. Second, the Court also rejected Pinnacle's claim that the Association was bound by the arbitration provision as a third party intended beneficiary. The Court of Appeal, in its opinion, noted that the Legislature had provided a complex, alternate dispute resolution procedure that a common interest development association must follow before it can file an action against a builder of a common interest development and ruled that such a holding would defeat the existing statutory construct. See, Civil Code § 1375, et seq. Third, the Court also ruled that the jury waiver provision contained in the purchase and sale agreements was unconscionable. The Court found that the arbitration agreement to be "highly" procedurally unconscionable and that the terms of the agreement were also substantively unconscionable, albeit to a lesser degree. The Court focused on the fact that the provision required the parties to bear their own costs, including expert costs, which added to the substantive unconscionability of the arbitration agreement.

It is noted that there was a dissent issued by Justice O'Rourke, but the majority opinion will be binding.

The decision in the Pinnacle Case is somewhat out of step with recent decisions which have broadly applied California's arbitration statute. However, the decision is in keeping with a general aversion by the courts to enforce provisions in the CC&Rs in favor of developers and also because of the procedures enacted by the State Legislature in regard to the resolution of common area disputes, so it may provide little guidance with respect to future cases interpreting the California Arbitration Act.

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