Appellate court upholds state statute

Rules that homebuilder's arbitration clause is enforceable

By Kim Jackson

THE COLORADO COURT OF APPEALS on May 6 upheld state law by stating that the mandatory arbitration provision in Metropolitan Homes, Inc.'s homeowners' association declaration was enforceable.

This decision reverses that made by the district court in the *Vallagio at Inverness Residential Condominium Association Inc. v. Metropolitan Homes Inc. et al* case, where the court decided that the developer's consent wasn't required to remove the arbitration provision because that declarant consent violated the Colorado Common Interest Ownership Act.

How the case evolved

Metro Inverness LLC developed the condominium project and served as its declarant for the homeowner's association until 2010, when it turned over control to the condominium owners. Just after the last (non-declarant) condominium was sold in 2012, the owners voted to remove the mandatory binding arbitration provision for construction defects claims — without the developer's required consent. Not

long after that, the association filed a construction defect lawsuit in district court — which found in favor of the homeowner association.

Where many homebuilders or developers would resign themselves to accept that decision, and hope for a better outcome by backing Homeownership Opportunity Alliance efforts for a legislative fix, Metropolitan Homes' CEO Peter Kudla and President Greg Krause had had enough, and appealed the decision.

"The track record in Colorado is that the legislation that has not been passed does not represent the fairness factor for the homebuilder," Kudla said. "They're guilty before they're even defined innocent."

Plaintiffs' attorneys goal: Create litigation opportunities

"What we have found is that construction defect litigators have one goal," Kudla explained, "and that is to create an opportunity for litigation. Their efforts to basically farm HOAs is a very strategic process. Whether there is defect or is not defect, they will try to create as much gray as possible. I find that personally and professionally appalling."

With few exceptions, most association management companies and board members are not attorneys or experts in interpreting the law. So, Kudla explained, "they rely heavily on these guys, who are just creating an engine for generation of fees. It's a forensic effort that is at times very inappropriately orchestrated."

For those reasons, Metropolitan Homes stood its ground. "We basically said, 'We have paid for the appropriate insurance. And we are going to use every avenue within our means to stand up for our position, our rights and the quality of the representation that we've made from Day One.' We pressured our insurance representatives to say that we did not want to stand by the trial decisions."

Homebuilders want the chance to make repairs

David McLain, chair of the Colorado Association of Home Builders' Construction Defects Task Force, added, "If what homeowners are looking for are legitimate repairs, the homebuilder is ready, willing and able to do that. The homeowner doesn't need to pay the plaintiffs' attorneys 40 percent of anything to get us to do it."

Kudla agreed. "We want the opportunity to make things right, and in this case, we haven't been able to do that because of the changes to the declaration."

Bigger payoffs with lawsuits than arbitration

McLain said tort attorneys pursue litigation for good reason. "While the measure of damage is exactly the same, juries award more money to a homeowner or homeowner's association than would an arbiter."

Before the Vallagio appellate court decision, McLain said, "there really was no mechanism under Colorado law for a builder to protect its arbitration rights. One of the first things plaintiffs' attorneys do upon being retained is go to the homeowners and get them to amend the declaration by taking out the arbitration piece, then file a lawsuit in district court. I've seen letters from plaintiffs' attorneys to members of associations, essentially laying that out."

Arbitration is already protected by law

Yet that very piece has been protected under state law since 2007. Amy Hansen, shareholder with Polsinelli, specializes in setting up homeowner association declarations. Along with other attorneys who themselves are experts, she authored Senate Bill 177 (which died in the legislative session this year), and wrote an amicus brief — a 'friend of the court' brief — to the Colorado Court of Appeals, which emphasized arbitration's protection by law.

"We already have a state statute that tells developers they can put these provisions in their declarations," Hansen explained. "Arbitration is already favored under state law. It's not like developers have been putting these arbitration clauses in here in a way that is sneaky or defies the law in some way. It's actually sanctioned by the Colorado Common Interest Ownership Act (CCIOA)."

Under Colorado Revised Statute, the CCIOA allows for specifying binding arbitration under the Uniform Arbitration Act (see Colorado Common Interest Ownership Act Section 38-33.3, subparagraph 124).

"So in this whole debate about arbitration, I think people have lost sight of the fact that when a developer has put in a binding arbitration clause, it's done so with the blessing and authority of existing state law," Hansen observed. "To me, I don't know how you can disregard section 124 of CCIOA, which truly gives developers permission to include these kinds of clauses. But that's what's been happening — until this case."

Clear and well-defined agreements are key

For its part, Kudla explained that Metropolitan Homes represents what it will do to the best of its abilities to all its subcontractors, its banks and most importantly, with its homebuyers.

"So we believe that we have been forthright from the very conception of a project with disclosures," Kudla said. "It has been defined as appropriate and legal in the formation of our declarations, our purchase and sale agreements, all of the related documents. And buyers have representation prior to the time that they buy. They read the documents, they're full disclosure, they're honest and they're binding."

Greg Krause, president of Metropolitan Homes, added that because all its agreements — trade partners, purchase, sales and HOA declarations— are in line with one another, "for one to be able to be changed without the consent or discussion with all parties involved, it affects everybody," Krause said.

Next step: Colorado Supreme Court

On June 18, the plaintiff's attorneys filed a writ of certiorari with the Colorado Supreme Court to hear the case. Metropolitan Homes can file a reply, and the Supreme Court will consider whether to take the case.

If it doesn't, Hansen explained, "then this decision stands. This was a fact-driven case, based on the declaration, as drafted. The Court of Appeals' decision provides good guidance for folks moving forward."

Court of Appeals decision fixes what bill tried to do during session

One of Senate Bill 177's key provisions was to set up prospective arbitration declarations, where homeowners couldn't later amend that out to sue a homebuilder. The bill laid out terms for how people may sue in the future, yet they couldn't retroactively affect a homebuilder's right to enforce an arbitration provision.

This was the most important part of the bill, because it's not something a homebuilder could accomplish on its own.

Hansen explained that if a developer had an arbitration clause, SB 177 would have held it in place, "no matter what the document said about amendments. With this case, the declaration has to speak to the amendment process. So this should take care of the arbitration issue, in large part, under SB 177."

The bill also provided that if a homeowner association was going to bring a construction defect claim against a homebuilder, it had to provide disclosures and get 67 percent of the homeowners to agree to amend the declaration. As outlined in the amicus brief, Hansen said, "that 67 percent cap only applies to the owner portion in any vote. It doesn't apply to all the other consents that might be required."

What's more, she added, "to use that to try and do an end run around an arbitration clause that CCIOA already says you can put in, to me, just seems completely unfair and quite frankly, a one-sided changing of the rules mid stream."

McLain added, "This is a momentous decision, if you look at how much time, effort and money has been spent at the legislature in the last few years, in order to protect arbitration."

If the Supreme Court decides to hear the case, the outcome probably won't be known before the next legislative session starts. If it does, McLain said another bill is likely to be introduced to statutorily protect the arbitration right, "just in case the case goes the other way." And it's a pretty safe bet to assume that plaintiffs are drafting something, too.

Review your declarations now

McLain observed that if you're planning a project with a homeowner association, look at your documentation now, to ensure it is protected under the current state of law. "If you want to protect your arbitration right, include a statement that it can't be amended out without your consent," he said. "That's enforceable."

Kudla recommends that homebuilders and developers "properly interpret the formation of covenants and declarations that speak to a clear voting procedure for the entity that is developing the property. And make sure that homebuyers clearly understand, acknowledge, what those voting rights are."

He added, "I believe that that's what we did at Vallagio in the documentation of our purchase and sale agreement. I think all homebuilders should recognize what that proper process is, disclose it properly, then stand by the absolute interpretation that the consumer has recognized that they made a choice to work within a particular system."

Every declaration is different

"For declarations that are already in existence," Hansen said, "it would just be a matter of looking to see whether the provisions in that existing declaration fit within the Vallagio decision."

While there's still a bit of uncertainty ahead, Hansen said, "This is a very, very positive opinion and court decision for the development community, to be certain."