CONSTRUCTION CASE UPDATE: Vallagio v. Metropolitan Homes: The Colorado Court of Appeals Decision Protecting a Declarant's Right to Arbitration Construction Defect Cases

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On May 7th, the Colorado Court of Appeals issued its much anticipated ruling in Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc., et al., 2015COA65 (Colo. App. May 7, 2015). By way of background, the Vallagio at Inverness Residential Condominiums were developed by Metro Inverness, LLC, which also served as the declarant for its homeowners association. Metropolitan Homes was Metro Inverness' manager and the general contractor on the project.

When it set up the Association, Metro Inverness included within the Association's declaration a mandatory arbitration provision specifically for construction defect claims. This provision stated that it "shall not ever be amended without the written consent of Declarant and without regard to whether Declarant owns any portion of the Real Estate at the time of the amendment."

In 2010, Metro Inverness turned control of the Association's board of directors over to the project's unit owners and it sold the last unit to a non-declarant owner in 2012. The next year, the project's unit owners voted to amend the declaration to remove, among other provisions, the mandatory binding arbitration provision for construction defect claims. In doing so, the unit owners did not obtain Metro Inverness' consent to amend that section. Soon after the unit owners amended the declaration, the Association filed a construction defect lawsuit in district court, naming as defendants, Metro Inverness, Metropolitan Homes, and the related principals.

The Metro defendants moved to compel arbitration, relying on the arbitration provision for construction defect claims and arguing that the purported amendment to remove it was invalid because the unit owners did not obtain Metro Inverness' consent for the amendment. The Association, in response, argued that the unit owners validly amended the declaration to remove the arbitration provision and that the declarant consent requirement violated the Colorado Common Interest Act ("CCIOA").

The district court denied the Metro defendants' motion to compel arbitration, concluding that Metro Inverness' consent was not required to remove the arbitration provision because, inter alia, the declarant consent requirement violated CCIOA and was, therefore, void and unenforceable. Specifically, the district court held that the declarant consent provision violated

C.R.S. § 38-33.3-302(2), which provides: "The declaration may not impose limitations on the power of the association to deal with the declarant that are more restrictive than the limitations imposed on the power of the association to deal with other persons." The court also found that the declarant consent provision violated C.R.S. § 38-33.3-217(1)(a)(I), which states:

> [T]he declaration . . . may be amended only by affirmative vote or agreement of unit owners to which more than fifty percent of the votes in the association are allocated or any larger percentage, not to exceed sixty-seven percent, that the declaration specifies. Any provision in the declaration that purports to specify a percentage larger than sixty- seven percent is hereby declared void as contrary to public policy, and until amended, such provision shall be deemed to specify a percentage of sixty-seven percent.

The Metro defendants then filed the interlocutory appeal of the district court's order, which resulted in this decision. In finding that the district court erred in this analysis, the Colorado Court of Appeals concluded that the provision requiring the declarant's consent to amend the arbitration provision for construction defect claims did not violate CCIOA and was, therefore, enforceable.

With respect to C.R.S. § 38-33.3-302(2), the Court of Appeals held that the declarant consent provision does not violate that section because the Association has no power to amend the declaration itself. Under the terms of the declaration, the power to amend the declaration resides with the unit owners, not the Association, and, therefore, the declarant consent requirement does not impose any limitation on "the power of the association" under section 38-33.3-302(2).

With respect to C.R.S. § 38-33.3-217, the Court of Appeals held that the statute does not prohibit a declaration from requiring declarant consent for an amendment. In so holding, the Court of Appeals pointed out that CCIOA does not explicitly preclude a declaration from imposing additional requirements for amendments and that, to the contrary, other provisions of section 217 contemplate requirements of consent or approval by parties other than unit owners. See C.R.S. § 38-33.3-217(1)(b)(I) (setting forth notification procedures applicable "[i]f the declaration requires first mortgagees to approve or consent to amendments"). On this topic, the Court concluded "that section 38-33.3-217(1)(a)(I) merely governs requirements for unit owners' voting percentages and does not prohibit a declaration from imposing an additional requirement of declarant consent for amendments."

Dispensing with the argument that the declarant consent requirement contravenes CCIOA's purpose, the Court of Appeals pointed out that:

> CCIOA endorses the use of alternative dispute resolution and specifically allows declarations to mandate binding arbitration. See § 38-33.3-124(3), C.R.S. 2014 ("The declaration . . . may specify situations in which disputes shall be resolved by binding arbitration."); § 38-33.3-124(1)(a)(II) ("The general assembly hereby specifically endorses and encourages associations, unit owners, managers, declarants, and all other parties to disputes arising under this article to agree to make use of all available public or private resources for alternative dispute resolution."). Given this statutory language and the public policy in Colorado favoring arbitration, see City & Cnty. of Denver, 939 P.2d at 1353, 1362, we cannot say that the declarant consent requirement in this case "evade[s] the limitations or prohibitions" of CCIOA, § 38-33.3-104.

For these reasons and others, the Court of Appeals concluded that the declarant consent provision was enforceable and consistent with CCIOA. "Because the unit owners did not obtain Metro Inverness' written consent, their attempt to remove the declaration's arbitration provision was ineffective. Accordingly, we conclude that the declaration still contains a valid and enforceable arbitration agreement as set forth in [the declaration]."

As a builder, the moral of the story here is that you need not rely on the Colorado Legislature to protect your ability to arbitrate construction defect claims asserted against you by homeowners associations. All you need to do is to include within your declaration a valid and enforceable declarant consent provision requiring your consent to amend out of the declaration the arbitration requirement for construction defect claims.

For additional information regarding the Vallagio decision, its impact, or how to comply with its guidance, you can contact David M. McLain by e-mail at mclain@hhmrlaw.com or by phone at (303) 987-9813 or visit their website at www.hhmrlaw.com. ■