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LEGAL PIPELINE

Colorado construction defects case benefits subcontractors, too!

BY STEVEN NUDELMAN CONTRIBUTING WRITER

In a long-awaited ruling, the Colorado Court of Appeals recently held that a homeowner's association could not remove a stipulation from its declaration mandating arbitration as the means of dispute resolution unless the builder/developer consents to its removal. Although the case, Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc., No. 14CA1154, 2015 Colo. App. LEXIS 693 (Colo. Ct. App. May 7, 2015), offers direct benefits to developers in Colorado – it also provides some indirect benefits to plumbing subcontractors and material suppliers alike.

Background

The story begins back in 2007, when Metro Inverness, LLC, along with its manager and general contractor, Metropolitan Homes, Inc., established the Vallagio at Inverness Residential Condominium project (the project) in beautiful Englewood, Colo. To set up the project as a condominium development under Colorado law, the developer (also known as the declarant), was required to prepare and record a formal declaration under the Colorado Common Interest Ownership Act ("CCIOA"), Colo. Rev. Stat. § 38-33.3-101 et seq. (2005). Acting as the declarant, Metro Inverness recorded the declaration for the project. However, the declaration included a few interesting, pro-developer provisions.

Section 16.6 of the declaration mandated arbitration to resolve any construction defect claims. (Thus, litigation in a court of law was not an option.) This section also provided that its terms, "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."

Metro Inverness turned control of the Vallagio at Invernesss Residential Condominium Association over to the condominium's unit owners in 2010, and in 2012 the last unit was sold by the developer. In September 2013, the association (under the control of the unit owners) voted to amend the declaration for the project to remove Section 16.6 in its entirety, including the mandatory arbitration provision. Notably, the association did not obtain the consent of Metro Inverness to amend Section 16.6.

The association's lawsuit

Shortly after amending the declaration, the association sued Metro Inverness, Metropolitan and some individual developer-defendants in Arapahoe County District Court, seeking damages for negligence, negligence per se, negligent repair, breach of implied warranty, misrepresentation/non-disclosure violations of the Colorado Consumer Protection Act, Colo. Rev. Stat. § 6-1-101 et seq. (1973), and breach of fiduciary duty – all claims related to construction defects at the project.

> Specifically, the appellate court found that the declaration was (a) not ambiguous and enforceable as written; and (b) not violative of the CCIOA. In sum, the Court of Appeals held that the declaration required arbitration of the construction defect claims against Metro Inverness.

In response, the defendants moved to compel arbitration based on Section 16.6 of the declaration. Specifically, the defendants argued that the amendment was invalid because the association failed to obtain Metro Inverness' consent prior to promulgating it.

The district court denied the defendants' motion on a number of grounds. The court found that the association did not require Metro Inverness' consent because:

The declaration had inconsistent, ambiguous provisions, which should be construed against the developer as drafter of the declaration.

And, Section 16.6 violated the CCIOA, making this section void and unenforceable.

As a result, the court held that

the association effectively amended the declaration to remove the arbitration provision. The defendants filed an immediate, interlocutory appeal of the district court's order.

The developer's appeal

Although the Colorado Court of Appeals addressed a number of arguments raised by the parties, the real significance of its decision is how it ruled on the above two holdings of the district court. Specifically, the appellate court found that the declaration was (a) not ambiguous and enforceable as written; and (b) not violative of the CCIOA. In sum, the Court of Appeals held that the declaration required arbitration of the construction defect claims against Metro Inverness.

Analyzing the first issue, the alleged ambiguity in the declaration, the Court of Appeals began by noting that in Colorado, arbitration is favored as a, "convenient and efficient alternative to resolving disputes by litigation. A valid and enforceable arbitration provision divests the court of jurisdiction over all arbitrable issues."

Therefore, the court had to determine whether the parties in fact had a valid agreement to arbitrate as set forth in the declaration. This determination hinged on the enforceability of Section 16.6.

The Court of Appeals applied ordinary contract principles to the declaration, interpreting its terms as written. It ultimately found that Section 16.6 was not ambiguous and not in conflict with other provisions of the declaration, "[A]s a matter of contract interpretation, the declaration required unit owners to obtain Metro Inverness' consent before amending the declaration to remove section 16.6, including its arbitration provision."

Turning to the second issue, the Court of Appeals examined three pertinent provisions of the CCIOA, which was enacted, "to establish a clear, comprehensive, and uniform framework for the creation and operation of common interest communities."

The declaration and CCIOA

The district court held that the declaration violated Section 38-33.3-302(2) of the CCIOA because it imposed unlawful limitations on the power of the association. Since Section 16.6 addressed the power to amend the declaration, and under Colorado law, the association has limited power to amend the declaration in any event, the Court of Appeals found that the declaration did not violate Section 38-33.3-302(2) of the CCIOA.

Next, the district court found that the declaration violated Section 38-33.3-217 of the CCIOA, governing the requisite vote of the unit owners to amend the declaration. The district court held that the declaration effectively required more than a percentage of unit owners to amend the declaration – it also required the consent of the developer. The Court of Appeals rejected this holding. Specifically, the court found that nothing in Section 38-33.3-217 precluded the developer from consenting to any amendments. This section merely provided the necessary vote by the unit owners to effectuate an amendment, and this percentage vote was still necessary. The addition of the developer's consent does not change that requirement.

Finally, the district court held that the declaration violated Section 38-33.3-303(5) of the CCIOA because it allowed the declarant to control the association after the declarant had turned control over to the association. The Court of Appeals likewise rejected this holding of the district court, "[A]mendments to a declaration are made by unit owners, not the association, Thus, CCIOA provisions regarding declarant consent to an association's actions are not pertinent to the issue before us."

In summing up its decision, rejecting all three, key holdings of the district court, the Court of Appeals noted, "[W]e conclude that the declarant consent provision is enforceable and consistent with the CCIOA. Because the unit owners did not obtain Metro Inverness' written consent, their attempt to remove the declaration's

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arbitration provision was ineffective. Accordingly, we conclude that the declaration still contains a valid and enforceable arbitration agreement as set forth in section 16.6."

What about subcontractors?

By now it should be evident that the Vallagio decision is a clear win for developers, who have the ability to foist arbitration of construction defect claims on condominium associations and unit owners permanently by means of a well-crafted declaration.

Developers prefer arbitration in these contexts for a number of reasons. First, arbitrations are private proceedings between the parties. They are not a matter of public record, unlike lawsuits, which are filed with court clerks. When a developer's condominium project is leaking like a sieve, the last thing that the developer wants is to be in the newspapers, with reporters quoting chapter and verse about the defects in the complaint.

Second, arbitrations, for the most part, are binding with limited rights to appeal. Thus, they provide a sense of finality to the parties and very often they proceed quicker than a lawsuit. This final, expeditious process favors a developer, who wants to conclude any dispute process quickly so that it could devote all of its energy to selling condominium units instead of defending a long, drawn-out lawsuit.

Third, arbitrations provide limited discovery. Again, when the developer is accused of providing a defective condominium property, the last thing that it wants to engage in is an extensive discovery process of document production, answering interrogatory questions and sitting for depositions. While some of this discovery is available in arbitration proceedings, it is very limited and often dependent on the preference of the arbitrator and the consent of the parties.

These are just a few of the reasons why a developer would want something like Section 16.6 in its declaration or master deed for a condominium development.

But what about plumbing engineers or material suppliers, who often act as subcontractors involved in the construction of an allegedly defective condominium development?

The Vallagio decision is quite favorable for them, too. First, if the association wants to seek relief from a plumbing subcontractor who worked on the project, the association has to do so by means of a separate lawsuit. Unlike the developer, the plumbing subcontractor is not a party to an agreement to arbitrate and thus, as a general rule, it cannot be compelled to arbitrate its disputes.

If, on the other hand, the Colorado Court of Appeals had affirmed the district court and allowed the association to sue the developer in court, then the association could join all of the subcontractors to the same lawsuit, and assert claims for negligence, breach of warranty and the like. This is a far more cost-effective, streamlined approach for the association, which does not want to maintain costly, parallel proceedings (arbitration against the developer and lawsuits against the subcontractors who worked on the project).

While most "armchair" construction attorneys see the obvious benefits to developers in the Court of Appeals decision, the case also merits a closer look for plumbing subcontractors and material suppliers. These parties also stand to benefit, albeit indirectly, from the inclusion of a permanent, mandatory arbitration in the declaration of a Colorado condominium development.

Steven Nudelman is a partner at the law firm of Greenbaum, Rowe, Smith & Davis LLP in Woodbridge and Roseland, New Jersey. He is a member of the firm's Litigation Department and its Construction, Alternative Dispute Resolution and Alternative Energy & Sustainable Development Practice Groups. He may be reached at (732) 476-2428 or snudelman@greenbaumlaw.com.