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PERSPECTIVE

A curious case of construction defects and unwaivable rights

By Timothy D. Reuben

Disappointingly, the 4th District Court of Appeal affirmed a trial court confirmation of an arbitration award that took away a homeowners association's right to seek relief for construction defects against the developer. *Branches Neighborhood Corporation v. CalAtlantic Group, Inc.*, 2018 DJDAR 8640 (Aug. 10, 2018). Justice Eileen Moore, joined by Justices Kathleen O'Leary and Richard Fybel, let stand a ruling that the HOA lost its right to sue because it failed to obtain a vote from its members to authorize suit until after the arbitration claim was filed. Ruling that the plain language of the covenants, conditions and restrictions controls, the HOA lost its claim because it failed to hold the vote or obtain written consent "[p]rior to filing a claim pursuant to the ADR Provisions."

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The Case

Branches Neighborhood Corporation, the HOA, filed a demand for arbitration with JAMS against a developer, CalAtlantic Group, for various construction defect claims seeking over $5 million in damages. It was undisputed that prior to filing the JAMS demand no vote was held. However, several months later, the HOA held a membership meeting and 92 of the 93 homeowners who attended voted to "[a]pprove and ratify the prosecution of the construction defect claim."

At arbitration before James Smith, a retired judge of the Orange County Superior Court, the developer moved for summary judgment, pointing out that the CC&Rs made *prior* consent a "condition precedent" to filing a construction defect claim. Despite the near-unanimous HOA vote, Smith granted the summary judgment motion ruling solely on the basis of no prior consent, finding the "after the fact expression of consent cannot be transmuted into the prior consent required by the CC&Rs," and further finding that the developer could take advantage of such a technical requirement to avoid any merits analysis of whether it was liable for the alleged defects.

The superior court and appellate court both affirmed.

A Curious Ruling

The members of the HOA specifically approved and ratified the decision to proceed with the litigation. Ratification, which is *implicitly* after the fact, is a long-respected and well-supported concept in the law. Corporations Code Section 5034, which the Court of Appeal acknowledged, specifically states that "'[a]pproval by (or approval of) the members' means approved or *ratified* by the affirmative vote of a majority of the votes." (Emphasis added.)

The obvious purpose of the requirement that the HOA obtain consent of its members is *not* to protect the developer from suit, but to *protect the members of the* HOA from unauthorized and potentially expensive litigation that the members would have to collectively pay for. So why does the developer have *any* standing to take advantage of this argument?

The Court of Appeal failed to acknowledge that the purpose of such prior consent is for the benefit of the members. Without explanation or logic, the court accepted that the developer — who typically during development must record CC&Rs — was a party to the CC&Rs "agreement" and that somehow its rights were "adversely" impacted by the after-the-fact ratification.

A Closer Look

Because the HOA technically did not comply with the prior consent provision, the arbitrator chose to ignore Corporations Code Section 5034 and all the other law that holds parties responsible and otherwise confirms acts if there is ratification. Instead, the arbitrator threw out what might have been meritorious construction defect claims.

Unfairness aside, arbitrators in California have been granted exceptional deference by the courts because of *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992), and its progeny. Courts will only disturb an arbitrator's decision under extremely limited circumstances. One such basis, relevant here, is if an arbitrator exceeds his or her "powers by issuing an award that violates a party's unwaivable statutory rights or that contravenes an explicit legislative expression of public policy."

Richey v. AutoNation, Inc., 60 Cal. 4th 909, 916 (2015).

The HOA argued that the right to ratify an association's actions was in fact an unwaivable statutory right. And the Court of Appeal, quoting *Sargon Enterprises, Inc. v. Browne George Ross LLP*, 15 Cal. App. 5th 749 (2017), said that if the arbitrator's decision "has the effect of violating a party's statutory rights or well-defined public policies — particularly those rights and policies governing the conduct of the arbitration *itself* — that decision is subject to being vacated or corrected."

So what exactly is an "unwaivable statutory right"? Is it any statute — there were several cited here, most significantly Corporations Code Section 5034, which the Court of Appeal simply brushed aside because the HOA did not cite any case interpreting the statute "in the context of a homeowners' association." But so what? That there is no prior case law directly on point is what the appellate courts are *expected* to address. Why is the members' right to ratify an HOA's actions after the fact not an "unwaivable statutory right"? There is little rationalization or explanation in the opinion — other than repeating that the CC&Rs use the word "prior," and that that word is clear. But clarity in the language does not address the issue of why there is not an unwaivable right here.

And why is the requirement of consent before filing not a right or policy "governing the conduct of the arbitration *itself* "? It has nothing to do with merits — just a technical precondition, like a corporation being required to pay its taxes before being authorized to litigate, something that is correctable after the fact. Doesn't the prior consent requirement merely confer a "right" to proceed? Isn't the right to proceed something that governs the conduct of the arbitration itself?

Furthermore, why is it not the public policy of this state that a developer who sells defective units should be held accountable through the litigation process to the numerous citizens of the state who purchased homes based on the promise that the homes were not defective? The public policy of a party's "right" to litigate is not even discussed, and the public policy issue is given short shrift, as the opinion merely repeats the argument that the CC&Rs are clear that consent be obtained "prior to" suing.

Perhaps the Court of Appeal was concerned about the fait accompli — that the HOA confronted its members with a very different type of decision after litigation had already been commenced and funds had already been expended and the intent was to let members decide before embarking on a serious lawsuit. However, the Court of Appeal never mentions this point — likely because the result simply punishes further those same homeowners by eliminating their ability to obtain any relief for the defects in their homes.

Conclusion

Clearly this decision, while doing little to clear up just what is an "unwaivable statutory right," sends several messages: If CC&Rs are express about prior consent, HOAs better comply. And further, the courts will not reach to find any basis in either unwaivable statutory rights or public policy to overturn an arbitrator's ruling, despite how unfair it may appear and despite no merits being decided.

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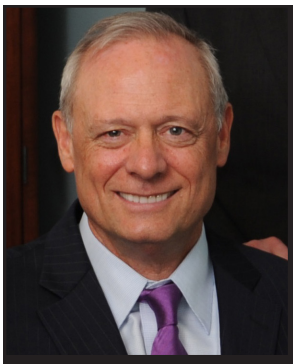

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