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Legal Update: California Supreme Court Recognizes Enforceability of Mandatory Arbitration Clause Recorded in CC&Rs in Construction Dispute Between Developer and Owners' Association

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The California Supreme Court has issued its long anticipated decision in *Pinnacle Museum Tower Association v. Pinnacle Market Development (U.S.), LLC, et al.* The Court upheld a condominium developer's ability to enforce a mandatory arbitration clause governing construction disputes between the developer and the owners' association ("Association"), where the clause had been included in covenants, conditions and restrictions (CC&Rs) recorded by the developer before the Association was created.

The Association had sued the developer for construction defects in project common areas. The developer sought to compel arbitration under the terms of the CC&Rs. The Association opposed, claiming that such a clause could not bind an Association that was not in existence and could not consent when the CC&Rs containing the arbitration clause were recorded. In addition to the arbitration clause in the CC&Rs, each original condominium owner had signed a purchase contract containing an arbitration clause covering construction defect claims and specifically referencing the Federal Arbitration Act ("FAA") and California Arbitration Act, thus waiving the right to trial by jury. The trial court and the court of appeal both ruled that the developer could not enforce the arbitration clause against the Association.

The Supreme Court reversed, reasoning that even though the Association was not in existence when the arbitration clause was placed in the CC&Rs by the developer, enforcement of such a clause as an equitable servitude was permissible and consistent with the Davis-Stirling Common Interest Development Act and other statutory law "unless unreasonable." The Court indicated that binding arbitration can benefit "both the developer and the entire common interest community by providing a speedy and relatively inexpensive means to address allegations of defect damage to the common areas and other property interests." The Court recognized that under the pre-emptive FAA, it would be inappropriate to "selectively target [the CC&R arbitration clause as] the only clause of the recorded declaration that does not memorialize an agreement binding t he Association." The Court also indicated that while unconscionability remains an appropriate challenge for unfair mandatory arbitration clauses, and despite the potentially adhesive nature of CC&Rs created before an Association exists, in the *Pinnacle* case there was no evidence of surprise to the owners or Association. In fact, there was evidence of the "developer's procedural compliance with the Davis-Stirling Act [as a] sufficient basis for rejecting an association's claim of procedural unconscionability." The Court also rejected lower court findings that the arbitration clause was substantively unconscionable, commenting that the Association failed to identify any aspect that was overly harsh or so one-sided so as to shock the conscience. The Court acknowledged that the challenged clause was limited to construction disputes and required the parties to bear their own attorneys' fees but found neither such provision to be unconscionable. The Court specifically noted that the purchase agreements signed by individual owners also served to notify those owners, before they purchased their units, to the existence of recorded CC&Rs and the arbitration provision in them.

Pinnacle confirms that it is permissible to include in such CC&Rs fair and reasonable arbitration clauses and that these clauses can bind owners' associations.

For more information about the *Pinnacle* decision and its implications, please contact Mark A. Cameron at 925.935.9400 or Mark.Cameron@MSRLegal.com. Mark A. Cameron is a shareholder in the firm's Walnut Creek office.
