VILLA VICENZA HOMEOWNERS ASSOCIATION,
Cross-Complainant and Respondent,
v.
NOBEL COURT DEVELOPMENT, LLC, Cross-Defendant and Appellant.
D054550
No. GIC871604
COURT OF APPEAL FOURTH APPELLATE DISTRICT
DIVISION ONE
STATE OF CALIFORNIA
Filed: January 11, 2011
CERTIFIED FOR PUBLICATION

APPEAL from an order of the Superior Court of San Diego County, Ronald Styn, Judge. Affirmed.

Luce, Forward, Hamilton & Scripps and Charles A. Bird; Allen Matkins Leck Gamble Mallory & Natsis and Valentine S. Hoy VIII for Cross-Defendant and Appellant.

Epsten Grinnell & Howell, Jon H. Epsten, Douglas W. Grinnell and Anne L. Rauch for Cross-Complainant and Respondent.

In this case the developer of a condominium project recorded a declaration of covenants, conditions and restrictions (CC&R's) which required that a homeowners association arbitrate any construction defect claim the association might have against the developer. As we explain more fully below, we find CC&R's are not an effective means of obtaining an agreement to arbitrate a homeowners association's construction defect claims against a developer.[1]

Although both federal and state law favor the enforcement of arbitration *agreements*, neither federal nor state law countenance imposition of arbitration where no agreement to waive judicial remedies exists. Admittedly, in other circumstances our cases and Civil Code section 1354 treat CC&R's as equitable servitudes which bind homeowners and homeowners associations with respect to claims they may have against each other. This treatment of CC&R's is not based on any determination the parties bound by them are in privity of contract with either their co-owners or a homeowners association. Rather, CC&R's are made binding in disputes between homeowners or between homeowners and a homeowners association because of their shared and continuing interest in the equitable and efficient operation of common interest developments. Here, the recorded CC&R's, standing alone, are not a contract between the developer and the homeowners association, which only came into existence after the CC&R's were recorded. Thus here there has been no showing the association entered into a binding arbitration agreement. Accordingly, the trial court did not err in denying the developers' motion to compel arbitration.

FACTUAL AND PROCEDURAL BACKGROUND

Nobel Court Development, LLC (Nobel), purchased the 418 apartments, common areas, and common facilities which make up the Villa Vicenza project in 2004 and converted the apartments to condominiums in 2005. In the course of making the property a condominium project, Nobel recorded CC&R's under which the Villa Vicenza Homeowners Association (the Association) came into existence upon the sale of the first condominium. By deed Nobel also transferred ownership of the common areas and common facilities to the Association. No consideration was provided by the Association to Nobel and the Association did not execute any documents in favor of Nobel in connection with the deed transferring the common areas and common facilities to the Association. In pertinent part, the CC&R's require that both condominium owners and the Association arbitrate any claims they have against the developer.

Because following the first sale Nobel controlled the board of directors of the Association and because the initial condominium buyers noticed defects in common areas and common facilities and did not believe Nobel had provided a reserve fund sufficient to repair the defects, the condominium owners brought a derivative action on behalf of the Association against Nobel.[2] Later, an independent litigation committee of the Association was

appointed and filed a cross-complaint against Nobel. The committee alleged claims for breach of implied warranty, strict liability, negligence and as the third-party beneficiary of express and implied warranties Nobel made to individual homeowners. Following unsuccessful efforts to mediate the Association's claims, Nobel filed a motion to compel arbitration under the provisions of the CC&R's. The trial court denied the motion with respect to the bulk of the Association's claims, but compelled arbitration of the express warranty claims. Nobel filed a timely notice of appeal. (Code Civ. Proc., § 1294, subd. (a).)

DISCUSSION
I

Because the trial court did not consider any disputed extrinsic evidence or otherwise resolve any disputed factual issues, we review its order on Nobel's motion to compel arbitration de novo. *(Giuliano v. Inland Empire Personnel, Inc.* (2007) 149 Cal.App.4th 1276, 1284.)

II

Both the Federal Arbitration Act (9 U.S. Code § 1 et seq. (FAA)) and its California counterpart, the California Arbitration Act (Code Civ. Proc., § 1280 et seq. (CAA)), make arbitration agreements enforceable and indeed favor them. (See *Moses H.*

Cone Memorial Hosp. v. Mercury Const. (1983) 460 U.S. 1, 24 [103 S.Ct. 927]; *Broughton v. Cigna Healthplans* (1999) 21 Cal.4th 1066, 1074-1075.) However, under both the FAA and the CAA, the question of whether a party has in fact entered into an arbitration agreement is determined by reference to state-law principles governing the formation of contracts. (See *First Options of Chicago, Inc. v. Kaplan* (1995) 514 U.S. 938, 942 [115 S.Ct. 1920], and *Marsch v. Williams* (1994) 23 Cal.App.4th 250, 254-255.)

Here, we do not believe the CC&R's Nobel recorded represent a binding agreement on the part of the Association to arbitrate its construction defect claims against Nobel. In reaching this conclusion we rely on our recent holding in *Treo @ Kettner Homeowners Assn. v. Superior Court* (2008) 166 Cal.App.4th 1055, 1066-1067 (Treo), and the provisions of Civil Code section 1354. Although as we explain the holding in *Treo* is not directly applicable to the arbitration provisions of the CC&R's, the principles it discusses are helpful in determining whether an agreement to arbitrate exists.

1. *Treo*

In *Treo* the developer of condominium project recorded CC&R's which made all disputes between the developer and the homeowners association subject to a judicial reference under Code of Civil Procedure section 638. The homeowners association sued the developer for construction defects and the developer moved to have the matter determined by a referee under Code of Civil Procedure section 638. The trial court granted the developer's motion and the homeowners association filed a petition for a writ of mandate. We issued the writ.

Because a reference under Code of Civil Procedure section 638 effectively waives a party's constitutional right to a jury trial, we found that under *Grafton Partners v. Superior Court* (2005) 36 Cal.4th 944, 950-952 *(Grafton),* no agreement to such a reference can be found absent actual notice to the party to be bound and meaningful reflection. *(Treo, supra,* 166 Cal.App.4th at pp. 1066-1067.) In *Grafton* the plaintiff had retained an accounting firm. The firm's engagement letter required that, in the event of a dispute, the parties would waive their right to a jury. The Supreme Court found this agreement was not enforceable because the Legislature has not expressly authorized such a pre-litigation waiver of the "inviolate right" to a jury trial as required by article I, section 16 of the California Constitution. *(Grafton, supra,* 36 Cal.4th at p. 951.) The court found this constitutional limitation on permissible jury waivers exists because the right to a trial by jury is " 'too sacred in its character to be frittered away or committed to the uncontrolled caprice of every judge or magistrate in the State.' " (Id. at p. 956.) Moreover, the court noted that even where a statute permits a jury waiver, the right to a jury is "considered so fundamental that ambiguity in the statute permitting such waivers must be 'resolved in favor of according to a litigant a jury trial.' " (Ibid.) Importantly, the court in *Grafton* noted that the states which have permitted a contractual jury waiver, have imposed a number of procedural safeguards not typical in commercial law, including requirements which place on

the party seeking enforcement of a waiver the burden of proving "the waiver clause was entered into knowingly and voluntarily." (*Id.* at p. 956.)

Having found that under *Grafton* a jury waiver requires actual notice and meaningful reflection, in *Treo* we found the constructive notice provided by the CC&R's did not meet those standards: "The difficulty here is the manner in which the 'contract' between [the developer] and [the homeowners association] waiving the right to trial by jury came about. As we have noted, an association, with its obligations and restrictions as defined in the CC&R's, essentially springs into existence when there is a conveyance by the developer of a separate interest coupled with an interest in the common area or membership in the association.

"It is at least arguable that there is some meeting of the minds between the developer and the party to whom the first conveyance is made. The problem, however, is that later purchasers and their successors, who will make up almost all association members, effectively have no choice but to accept the CC&R's prepared by the developer, including in this case the waiver of the right to trial by jury.

"We conclude this is not the situation the legislature contemplated when it enacted section 638 to allow parties to waive by contract the 'inviolate' constitutional right to trial by jury. As *Grafton* suggests, Legislatures when providing for the contractual waiver of that right are particularly concerned with the formalities of the process and the actual existence of a mutual agreement to waive the right. [Citation.]

"Treating CC&R's as a contract such that they are sufficient to waive the right to trial by jury does not comport with the importance of the right waived. CC&R's are notoriously lengthy, are adhesive in nature, are written by developers perhaps years before many owners buy, and often, as here with regard to the waiver of trial by jury, cannot be modified by the association. Further, the document is not signed by the parties." *(Treo, supra,* 166 Cal.App.4th at pp. 1066-1067.)

In finding CC&R's were not a permissible means of obtaining a jury waiver, we recognized that in *Villa Milano Homeowners Assn. v. IL Davorge* (2000) 84 Cal.App.4th 819, 828-835 *(Villa Milano),* the court reached a contrary conclusion and found that because in other contexts the CC&R's had been treated as binding upon purchasers of interests in common interest developments, the CC&R's could be used to obtain agreements to arbitrate. *(Treo, supra,* 166 Cal.App. 4th at p. 1065.) We declined to follow that aspect of *Villa Milano.* We noted that *Villa Milano* was decided before *Grafton* and further that: "Treating CC&R's as equitable servitudes makes possible the existence of common interest communities because they allow the continued governance of the community when multiple parties own the property and when such ownership changes over time. The very nature, however, of the creation of CC&R's creates a distance in time and control between the parties that are bound by them. While it may be reasonable under such circumstances to bind owners and the association concerning the governance of the community and the placement of restrictions on the use of property, we conclude the Legislature did not intend that CC&R's be sufficient to effectively and permanently waive the constitutional right to trial by jury." *(Treo, supra,* 166 Cal.App.4th at p. 1067.)

2. *Arbitration Agreement*

As Nobel points out, where an arbitration agreement is covered by the FAA, the FAA preempts any conflicting state law. *(Shepard v. Edward Mackay Enterprises, Inc.* (2007) 148 Cal.App.4th 1092, 1097-1099.) Thus Nobel argues the jury waiver provisions in the California Constitution we relied on in *Treo* cannot be used to adversely impact its right to compel arbitration under the FAA.

We agree with Nobel that any purported agreement between it and the Association would be covered by the FAA and that where the FAA applies, the California Constitution cannot be used to treat arbitration agreements differently than other types of agreements. However, the FAA, like the CAA, only imposes arbitration on parties which have *agreed* to forego resort to judicial remedies. In this regard, while it is true in *Treo* we found that the CC&R's do not meet the particular requirements of the California Constitution, our analysis in *Treo* of the manner in which the CC&R's operate, as well as our further consideration of Civil Code section 1354, persuade us a developer may not obtain any contractual rights, including the right to arbitration, by the simple expedient of recording the CC&R's. Neither the circumstances by which the CC&R's are recorded nor their controlling impact on disputes between those with an ownership interest in or responsibility for the operation of a common interest development

give rise to any sort of binding agreement between developers who have recorded the CC&R's and those who might in the future be burdened by them.

a. *FAA Pre-Emption*

Nobel notes that by their terms the CC&R's state: "Because many of the materials and products incorporated into the home are manufactured in other states, the development and conveyance of the Property evidences a transaction involving interstate commerce and the Federal Arbitration Act (9 U.S.C. § 1, et seq.) now in effect and as it may be hereafter amended will govern the interpretation and enforcement of the arbitration provisions of this Declaration." The facts set forth in the CC&R's are hardly matters subject to serious dispute. Nobel's condominium project was a substantial multi-family housing development composed of literally hundreds of dwelling units, the construction of which no doubt necessitated myriad contacts with and impacts on interstate commerce. Moreover, it can hardly be a matter of controversy interstate commerce was involved in financing the purchase of hundreds of individual condominiums from Nobel. Thus, the connection between the project and interstate commerce is manifest here and more than sufficient to support application of the FAA.

In this regard the United States Supreme Court's opinion in *Citizens Bank v. Alafabco, Inc.* (2003) 539 U.S. 52, 55-58 [123 S.Ct. 2037], is controlling. In *Citizens Bank v. Alafabco, Inc.*, an Alabama borrower entered into a series of debt-restructuring agreements with an Alabama bank. Each of the restructuring agreements contained arbitration provisions. Because the borrower believed the bank had reneged on an agreement to provide the borrower with working capital, the borrower sued the bank, which then moved to compel arbitration.

In finding a connection with interstate commerce sufficient to support application of the FAA, the court found application of the FAA was not "defeated because the individual debt-restructuring transactions, taken alone, did not have a 'substantial effect on interstate commerce.' [Citation.] Congress' Commerce Clause power 'may be exercised in individual cases without showing any specific effect upon interstate commerce' if in the aggregate the economic activity in question would represent 'ageneral practice... subject to federal control.' [Citations.] Only that general practice need bear on interstate commerce in a substantial way. [Citations.]" *(Citizens Bank v. Alafabco, Inc., supra,* 539 U.S. at pp. 56-57.)

The court found the debt-restructuring agreements not only involved interstate commerce because of the borrower's substantial interstate business, but also because the restructured debt was secured by all of the debtor's business assets, "including its inventory of goods assembled from out-of-state parts and raw materials. If the Commerce Clause gives Congress the power to regulate local business establishments purchasing substantial quantities of goods that have moved in interstate commerce, *Katzenbach v. McClung*, 379 U.S. 294, 304-305, 85 S.Ct. 377, 132 L.Ed.2d 290 (1964), it necessarily reaches substantial commercial loan transactions secured by such goods." *(Citizens Bank v. Alafabco, Inc., supra,* 539 U.S. at p. 58.) The court further found that "were there any residual doubt about the magnitude of the impact on interstate commerce caused by the particular economic transactions in which the parties were engaged, that doubt would dissipate upon consideration of the 'general practice' those transactions represent. [Citation.] No elaborate explanation is needed to make evident the broad impact of commercial lending on the national economy or Congress' power to regulate that activity pursuant to the Commerce Clause." (Id. at pp. 58-59.)

Similarly, here it can hardly be disputed Congress has the power to regulate the sale and financing of a large residential development. The financing alone, implicates the use of federally regulated and chartered financial institutions with well-recognized impacts on interstate commerce, and thus supports application of the FAA under *Citizens Bank v. Alfabaco, Inc.* In this regard we note that under the Civil Code section 1351, subdivisions (a), (j) and (k), creation of the Association and its ownership of common areas and facilities was an integral part of the creation of the condominium project.

Application of the FAA to the transfer of property to the Association, prevents us from enforcing restrictions on the use of arbitration in construction defect cases which the Legislature enacted as Code of Civil Procedure section 1298 et seq. (See *Shepard v. Edward Mackay Enterprises, Inc., supra,* 148 Cal.App.4th at pp. 1097-1101.) "States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.' [Citation.] What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit),

but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful...." *(Allied-Bruce Terminix Companies, Inc. v. Dobson* (1995) 513 U.S. 265, 281 [115 S.Ct. 834].) The FAA also prevents us from relying on the jury waiver provisions of the California Constitution to invalidate an arbitration agreement. Those provisions of our Constitution would improperly discriminate against arbitration because they would not necessarily invalidate other portions of an agreement which, although lacking actual notice and meaningful reflection, do not purport to waive the right to a jury.

b. *Contract Formation*

However, as we have noted, state law does govern the question of whether an agreement to arbitrate has been made. (See *First Options of Chicago, Inc. v. Kaplan, supra*, 514 U.S. at p. 942, and *Marsch v. Williams, supra*, 23 Cal.App.4th at pp. 254255.) In this regard we do not believe the Legislature intended that the CC&R's by themselves could be used as a means of creating any continuing contractual rights between the developer of common-interest development and either a homeowners association or individual homeowners with whom a developer has no contractual relationship.[3]

The express provisions of Civil Code section 1354 state: "(a) The covenants and restrictions in the declaration shall be enforceable equitable servitudes, unless unreasonable, and shall inure to the benefit of and bind all owners of separate interests in the development. Unless the declaration states otherwise, these servitudes may be *enforced by any owner of a separate interest or by the association or by both.* (Italics added.)

"(b) A governing document other than the declaration may be enforced *by the association against an owner of a separate interest or by an owner of a separate interest against the association."* (Italics added.)

Our review of the CC&R's Nobel recorded reveals they are consistent with Civil Code section 1354 and state an intent to benefit only the owners of separate units and provide a right of enforcement only to owners and the Association. Thus neither Civil Code section 1354 nor the terms of the Association's CC&R's express any intent to benefit Nobel in its capacity as developer of the project or provide it with any general right to enforce the CC&R's, other than as the owner of unsold units.

Limiting enforcement of CC&R's to owners and associations which act on behalf of owners is entirely consistent with the cases which have used contract principles to interpret and enforce CC&R's. (See e.g. *Citizens for Covenant Compliance v. Anderson* (1995) 12 Cal.4th 345, 349 [CC&R's need not be referenced nor repeated in each succeeding deed to be enforceable by other owners]; *Frances T. v. Village Green Owners Assn.* (1986) 42 Cal.3d 490, 512-513 [CC&R's as contract between homeowner and homeowners association with respect to installation of common area lighting]; *Barrett v. Dawson* (1998) 61 Cal.App.4th 1048, 1054 [CC&R's as contract between neighboring property owners prohibiting use of residential property for business activities]; and *Franklin v. Marie Antoinette Condominium Owners Assn.* (1993) 19 Cal.App.4th 824, 828, 833-834.) Each of those cases involved disputes either between homeowners or between homeowners and a homeowners association. As we noted in *B.C.E. Development, Inc. v. Smith* (1989) 215 Cal.App.3d 1142, 1149 *(B.C.E):* "Recent times have seen increased development of multi-residential units which are interrelated. Condominium construction introduced the concept of common space dividers, both vertical and horizontal. Open as well as communal space reserved for the common use of tract residents became a typical benefit of developments, both in the form of condominiums and separated dwelling unit tracts. Private internal roads and gated entrances gave rise to the necessity of guards and maintenance personnel for the service of all residents of the development. Regulation of the rights, *inter se*, of the residents could be achieved, and assured, only by the adoption of highly detailed and specific regulations, imposed on initial buyers and successors in interest alike by the use of recorded mutual agreements.... [¶].... Typically, the interest in enforcing restrictions will be common to most, if not all, members of the community. Requiring individual landowners to shoulder the burden of enforcement litigation would be unreasonable. The administration of the common areas in the development is typically allocated to a homeowners association, or to some other entity constituted to represent all of the owners. Often at the inception of the development the enforcement entity is created and controlled by the developer of the project. It is highly reasonable in these circumstances that the representative association or other central agency undertake, on behalf of all homeowners, such litigation as may be required to enforce the CC&Rs."[4]

The rationale for limiting the enforcement of CC&R's to owners and representative associations can be found in the reasons we were unwilling in *Treo* to find that CC&R's may be used as a means of waiving the right to a jury.

CC&R's are generally, as here, adhesive and unilateral and those bound by their terms may only have constructive notice of those terms and no contractual relationship with the developer who drafted the CC&R's. While, notwithstanding these considerable procedural shortcomings, CC&R's may be a practical and necessary means of nonetheless governing the ongoing relationship between owners of common interest developments or adjoining property (see *Citizens for Covenant Compliance v. Anderson, supra*, 12 Cal.4th at pp. 360-369), no such practicality or necessity exists with respect to the rights or obligations of developers or other third parties.

A related rationale can be found in historic limitations on the enforceability of covenants running with the land. In that regard, our holding in *Kelly v. Tri-Cities Broadcasting, Inc.* (1983) 147 Cal.App.3d 666, 678-679 *(Kelly),* is instructive. In *Kelly* we held a rental arbitration provision in a lease only bound an assignee of the initial lessee while the assignee was a tenant. We found the agreement to arbitrate in the lease was a covenant which ran with the land because it concerned rent and therefore was a covenant whichtouches and concerns" the land.' " (Id. at p. 679.) However, we further noted the inherent limitation on the enforceability of covenants running with the land: "This rule is based upon privity of estate, not privity of contract. When the privity of estate no longer exists, those covenants running with the land, based upon that privity, are no longer enforceable. Thus the covenant to arbitrate is binding upon a nonassuming assignee only as to matters arising during the term or period that the assignee was bound by privity of estate. No authorities predict an agreement to arbitrate could be stretched to require arbitration of a claim for rent due after the premises had been abandoned, after the privity of the estate has been broken." *(Ibid.;* see also *Melchor Investment Co. v. Rolm Systems* (1992) 3 Cal.App.4th 587, 592-593.)

The use of CC&R's as a means of providing contractual rights to parties with no interest in or responsibility for a common interest development is also problematic from the standpoint of determining what if any consideration would support such third-party agreements. By their terms the CC&R's bind all successors, even those with whom a third party such as Nobel has never had any contractual relationship and to whom Nobel has not provided any consideration.[5]

In light of the foregoing, we do not believe that in providing in Civil Code section 1354 that CC&R's be treated as equitable servitudes, the Legislature intended that CC&R's would be used to provide continuing and irrevocable contractual benefits to entities such as Nobel, which have no continuing interest in a development or role as a representative of the owners of the development. Thus the trial court did not err in denying Nobel's motion to compel arbitration.

Order affirmed.

BENKE, Acting P. J.

WE CONCUR:

NARES, J.

McINTYRE, J.

Notes:

[1.] We recognize this issue is currently pending before our Supreme Court. (See e.g., *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC,* review granted November 10, 2010, No. S186149.)

[2.] The individual condominium buyers also brought claims on their own behalf and by way of a prior order, which is not the subject of this appeal, the trial court ordered those individual claims be arbitrated.

[3.] We express no opinion with respect to parties with whom a developer has a contractual relationship.

[4.] In *B.C.E.* we held that a developer, as the declarant which recorded CC&R's, could reserve the power to enforce the CC&R's, notwithstanding the fact the developer no longer had any interest in the development. However

the CC&R's we considered in *B.C.E.* were recorded in 1968 and concerned a subdivision of separate parcels. The *B.C.E.* CC&R's were not subject to the current version of section 1354 or its statutory predecessor. (See Stats. 1963, ch. 860.) Importantly, in finding that the developer could enforce the CC&R's, we found the developer, which was attempting to enforce architectural restrictions, was acting not in its own interest, but as the only logical representative of all the property owners in the development. *(B.C.E., supra,* 215 Cal.App.4th at pp. 1149-1150.) Here, Nobel is acting solely in its own pecuniary interest and not as the representative of anyone with any existing interest in the development. In this case the enforcement role we endorsed in *B.C.E.* is being filled by the Association under the terms of section 1354.

[5.] We note that under sections 1355 through 1357 and the terms of the Association's CC&R's, the Association has the power to amend the CC&R's. Because it appears from the record that Nobel controlled the Association until after these proceedings were initiated, we draw no inference from the Association's failure to amend the CC&R's.
