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Amending the Declaration to Remove an Arbitration Provision

In our practice representing associations in construction defect actions, we are seeing an increase in governing documents containing mandatory arbitration provisions attempting to restrict the HOA's right to pursue its claims in court. These provisions have been inserted into the governing documents by the builder upon creation of the association, before any of the units have been sold to individual homeowners, and before the builder has turned over control of the association to the homeowners. This article addresses the validity of such provisions, and the steps the association can take to remove them from its governing documents.

What is Arbitration?

Before going too far, a brief look at arbitration might be useful. Arbitration is a form of alternative dispute resolution that involves a third-party arbitrator (either an individual or a panel) who decides the outcome of a case after presentation of evidence by both sides. For purposes of this article, the decision of the arbitrator is final, and has the same effect as if it were rendered by a judge or jury in a court of law. In addition, absent certain errors, the arbitrator's decision cannot be appealed. Arbitration's main benefit is efficiency. Cases tend to move through arbitration more quickly and less expensively than if they were to go to court.

However, there are also some significant disadvantages to arbitration. One major disadvantage is that damage awards in arbitrations tend to be less than those in jury trials. Arbitration could therefore have a disastrous effect on an association pursuing construction defect claims if the award was not enough to allow the association to make necessary repairs. In addition, the discovery limits that make arbitration faster and less expensive than litigation may also prevent the association from uncovering evidence necessary to present their case. Further, the arbitrator makes *all* the decisions during the process and those decisions are typically not subject to appeal. Thus, once arbitration begins, the association is generally stuck with those decisions, for better or for worse.

Validity of Arbitration Provision in the Declaration

The Colorado Common Interest Ownership Act (CCIOA) grants associations certain rights that can be used to invalidate an arbitration provision in an association's governing documents. These include: 1) the right to institute *litigation* on matters affecting the



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common interest community (C.R.S. § 38-33.3-302(d)); and 2) the right to a *judicial proceeding* to enforce any right declared by CCIOA (C.R.S. § 38-33.3-114(2)). To further protect associations, CCIOA states that an association cannot waive these rights (C.R.S. § 38-33.3-104).

CCIOA also states that the declaration may not impose limitations on the powers of the association to deal with the builder that are more restrictive than the limitations imposed on the power of the association to deal with other persons (C.R.S. § 38-33.3-302(2)). Thus, where the declaration requires the association to arbitrate construction defect claims with the builder (as opposed to pursuing such claims through litigation), that provision is likely invalid because the association is not similarly restricted to arbitrate claims it may have against others.

Amending to Remove the Arbitration Provision

An alternative to legally challenging the validity of an arbitration provision in an association's governing documents is to amend the document to remove the arbitration provision. Our firm recently had this course of action approved by the Colorado Supreme Court in a case entitled *Eagle Ridge Condominium Association v. Metropolitan Builders, et al.* In *Eagle Ridge*, the association amended its bylaws to remove a mandatory arbitration provision before going to court. The court held that the amendment eliminated any arbitration rights, even as to claims arising before the bylaws were amended.

Possible Amendment Issues

Sometimes, in addition to an arbitration provision, the governing documents contain provisions attempting to discourage or prevent an amendment to remove them. Such provisions include a builder approval requirement; a lender approval requirement; a super majority requirement; or a combination of all three.

A builder approval requirement for amending an association's governing documents violates numerous sections of CCIOA and it is therefore unlikely any court would uphold such a requirement. Likewise, while lender approval requirements to amend a declaration may be valid under certain circumstances, such requirements cannot impair an association's right to engage in litigation. Thus, a lender approval requirement prior to amending to remove an arbitration provision is also likely unenforceable. It is less clear whether a super majority requirement (requiring more than 50% unit owner approval) is valid with respect to an amendment removing an arbitration provision from the declaration. If such a provision exists, the association would be wise to comply with the provision, or to seek professional assistance in interpreting the validity of the provision.