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COLORADO'S CONDO MARKET: THE FIGHT OVER MANDATORY ARBITRATION

I. INTRODUCTION

Colorado's condominium (condo) market has been stagnant for nearly a decade, and the Colorado Common Interest Ownership Act (CCIOA) is largely to blame. Developers are weary of expensive, and often frivolous, lawsuits. To lure builders back to Colorado, lawmakers should amend the CCIOA to allow for arbitration of a construction defect claim regardless of whether the association later amends the governing documents. However, the legislature should protect the unit owners by mandating that the arbitrator is a neutral third party. This short article will explain the current state of affordable housing in Colorado, explore a relevant Colorado Court of Appeals decision, analyze the shortfalls of the CCIOA, and propose legislative action.

II. IMPEDIMENTS TO THE GROWING CONDO MARKET

A. Affordable Housing Shortage in the Denver Metro Area

Colorado lawmakers have failed to strike a balance between protecting homeowners from shoddy construction and shielding condo developers against rising insurance rates as a direct result of countless lawsuits.[1] The stalemate over the construction defects reform has created a shortage of affordable housing for the middle class.[2]

Denver Mayor Michael Hancock expects more than 100,000 people to move to Denver in the next decade.[3] A person might expect to see condo complexes being built on every street corner in Denver. However, Denver's condo market has dropped dramatically over the past decade. In downtown Denver, 870 townhomes or condos were erected in 2007, but only fifty-nine went up in 2015.[4] Mayor Hancock and other city

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[1] *See* Brian Eason & John Frank, *The Top 10 Issues Facing Colorado Lawmakers in the 2017 Session*, DENVER POST (Jan. 8, 2017), http://www.denverpost.com/2017/01/08/10-issues-colorado-lawmakers-2017.

[2] *See* John Rebchook, *Hancock Testifies in Favor of Condo Construction Defect Bill*, DENVER REAL ESTATE WATCH (Mar. 19, 2015), http://www.denverrealestatewatch.com/2015/03/19/hancock-testifies-in-favor-of-condo-construction-defect-bill.

[3] *Id.*

[4] John Aguilar, *Colorado's Condo Problem: Local Construction Defects Laws Complicate Statewide Reform Effort*, DENVER POST (Jan. 11, 2016), http://www.denverpost.com/2016/01/11/colorados-condo-problem-local-construction-defects-laws-complicate-statewide-reform-effort.

mayors blame Colorado's current construction defect laws for the housing shortage.[5]

In 2015, the Colorado legislature failed to enact legislation that would have mandated binding arbitration involving construction defect claims if the developer drafted a valid arbitration clause. In response to the failed legislation, more than a dozen local governments implemented ordinances making it harder for associations and unit owners to sue developers.[6] For example, Lakewood passed a measure in 2014 that would protect builders in an attempt to attract developers back to Colorado.[7] However, as of early 2016, Lakewood had not received a single application.[8] Because of the uncertainty with the state construction defect laws, developers remain hesitant to build in Colorado, fearing expensive litigation and excessive insurance rates.

B. Colorado Common Interest Ownership Act

Condos are part of common interest communities,[9] and the CCIOA "establish[es] a clear, comprehensive, and uniform framework for the creation and operation of common interest communities."[10] Despite the CCIOA recognizing that the "economic prosperity of Colorado is dependent upon the strengthening of homeowner associations in common interest communities," the law is often the main impediment to condo development.[11]

To illustrate, condo developers often draft an arbitration clause into the common interest community declaration and require homeowner associations to obtain consent from the developer prior to removing the clause. However, the CCIOA has its own "[a]mendment of declaration" provision that says that a declaration may be amended only by majority vote of unit owners, but requiring greater than sixty-seven percent vote of the unit owners is void as contrary to public policy.[12] It is common practice for homeowner associations to vote to remove an arbitration clause despite the CCIOA encouraging the use of alternative dispute resolution.[13] Allowing associations to remove a developer consent

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[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *See* COLO. REV. STAT. § 38-33.3-103(9) (2016) ("'Condominium' means a common interest community in which portions of the real estate are designated for separate ownership and the remainder of which is designated for common ownership solely by the owners of the separate ownership portions. A common interest community is not a condominium unless the undivided interests in the common elements are vested in the unit owners.").

[10] *Id.* § 38-33.3-102(1)(a).

[11] *Id.* § 38-33.3-102(1)(b).

[12] *See id.* § 38-33.3-217.

[13] *Id.* § 38-33.3-124(1)(a)(I).

provision, and then near-simultaneously voting to remove the arbitration clause from the declaration, is one example of the CCIOA not providing adequate protection for builders from frivolous lawsuits.

C. Can Developers Contract Around the CCIOA?

In *Vallagio at Inverness Residential Condo. Ass'n v. Metro. Homes, Inc.*,[14] the Colorado Court of Appeals addressed the issue of whether a homeowner association (Association) could remove a valid arbitration clause from the association declaration without the consent of the builder.[15] The dispute began when over sixty-seven percent of the unit owners voted to remove the arbitration clause from the declaration despite the original declaration requiring the builder's consent prior to removing the clause.[16] Soon after the amendment, the Association sued the developer for construction defects.[17] The trial court denied the developer's motion to compel arbitration because it found the amendment legally removed the arbitration clause in compliance with the CCIOA.[18]

The Colorado Court of Appeals reversed.[19] The court held that § 217 of the CCIOA, which voids provisions that require greater than sixty-seven percent of the unit owner's consent, did not prohibit a developer from withholding final consent (what the Colorado Supreme Court reframed as a veto power).[20] The court also rejected the Association's argument that claims brought under the Colorado Consumer Protection Act (CCPA) are non-arbitrable.[21] Because the General Assembly did not explicitly state that civil claims brought under the CCPA are non-waivable, the appeals court determined that the arbitration clause was valid.

On June 20, 2016, the Colorado Supreme Court granted certiorari to hear the case on two grounds. The first issue on appeal is whether the CCIOA "permits a developer-declarant to reserve the power to veto unit owner votes to amend common interest community declarations."[22] The second issue is whether the CCPA claims are "subject to pre-dispute

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[14] Vallagio at Inverness Residential Condo. Ass'n v. Metro. Homes, Inc., No. 14CA1154, 2015 WL 2342128, at *1 (Colo. App. May 7, 2015), *cert. granted*, No. 15SC508, 2016 WL 3453507 (Colo. June 20, 2016).

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.* at *11.

[20] *Id.* at *6.

[21] *Id.* at *10.

[22] Vallagio at Inverness Residential Condo. Ass'n v. Metro. Homes, Inc., No. 15SC508, 2016 WL 3453507, at *1 (Colo. June 20, 2016).

mandatory arbitration provisions where [the Colorado Supreme Court] previously held, 'We leave open the question of whether CCPA claims might be deemed non-arbitrable.'"[23]

III. CONDO CONSTRUCTION DEFECT CLAIMS SHOULD BE RESOLVED THROUGH ARBITRATION

A. Proposed Legislative Action

For four consecutive legislative sessions, Colorado lawmakers have introduced bills making it more difficult for homeowners to sue developers for substandard construction. Each year, the proposed bills fail. Senate Bill 15-177 (SB 177) was the latest to fail. SB 177 would have protected builders by mandating mediation before a neutral third party as a condition precedent to filing any construction defect claim.[24] Additionally, if the developer includes a mandatory arbitration clause for resolving construction defect disputes in the governing documents, that clause would be binding on homeowners despite a later amendment to the governing documents that removes or amends the clause.[25]

Until *Vallagio*, homeowner associations freely amended their declarations, by a majority vote of homeowners, to remove the arbitration provision added by the builder.[26] Associations would routinely take such action immediately prior to filing a construction defect claim in court in order to avoid arbitration.[27] Allowing such methods encouraged "lawsuits ahead of settlements" and rewarded lawyers who could convince multiple homeowners to sue.[28] This practice worked in Colorado until the Colorado Court of Appeals struck it down in May 2015.[29]

Proponents of SB 177 believe such a measure would protect builders against frivolous lawsuits, which in turn would reduce insurance rates for developers and reduce home prices.[30] Indeed, Mayor Hancock

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[23] *Id.*

[24] S.B. 15-177, 70th Gen. Assemb., Reg. Sess. (Colo. 2017).

[25] *Id.*

[26] John Aguilar, *Construction-Defects Bill Gets Green Light in Colorado Senate*, DENVER POST (Apr. 10, 2015), http://www.denverpost.com/2015/04/10/construction-defects-bill-gets-green-light-in-colorado-senate.

[27] *See* Vallagio at Inverness Residential Condo. Ass'n v. Metro. Homes, Inc., No. 14CA1154, 2015 WL 2342128, at *1 (Colo. App. May 7, 2015), *cert. granted*, No. 15SC508, 2016 WL 3453507 (Colo. June 20, 2016).

[28] Eli Segall, *Analysis: Is Construction-Defect Law Stunting Nevada's Housing Market?*, LAS VEGAS SUN (Feb. 20, 2015), https://lasvegassun.com/news/2015/feb/20/analysis-construction-defect-law-stunting-nevadas.

[29] *See Vallagio*, 2015 WL 2342128, at *8.

[30] *See* Aguilar, *supra* note 4; *see also* Kris Hudson, *Nevada, Other States Target Construction-Defect Lawsuits*, WALL ST. J. (Feb. 25, 2015), http://www.wsj.com/articles/nevada-other-states-target-construction-defect-lawsuits-1424912880 (explaining that prior to Nevada

testified in favor of the bill because he said it was a crucial step to bringing affordable housing to Denver.[31] He added that over the previous few years, the only condo projects built were at a price point beyond the reach of most residents.[32]

Colorado lawmakers should reintroduce a bill similar to SB 177. Statewide measures are necessary to protect developers from expensive litigation. SB 177 protected the unit owners as well by requiring that the arbitrator be a neutral third party.[33] If there is any doubt about the neutrality of the arbitrator, any proposed legislation should provide a mechanism for a state court to appoint a neutral arbitrator.[34]

B. The Current Bipartisan Proposal Will Not Adequately Address Builders' Concerns

After four consecutive years, the legislature is again attempting to address the construction defect laws. Colorado House Speaker Crisanta Duran outlined her efforts in her opening remarks of the 2017 legislative session.[35] The Speaker's proposed bill, which is co-sponsored by Kevin Grantham, president of the Senate, would require an expedited court proceeding to apportion the costs of defense when more than one insurer has a duty to defend in a construction defect action.[36] Instead of pushing for mandatory arbitration, Speaker Duran introduced a bipartisan bill that would address the high insurance rates, which she claims is "one of the root causes making it harder to build more new condos."[37] Unlike SB 177, Speaker Duran's bill does not address the CCIOA and instead targets the Construction Defect Action Reform Act (CDARA).[38]

But this proposed bill would not address the issue of frivolous lawsuits. It would only distribute the costs of lengthy litigation to multiple insurance companies. Without more data, it is difficult to predict whether insurance companies would lower premiums. Until the legislature makes it more difficult for homeowners to litigate frivolous cases, insurance rates will remain high and thus encourage developers to build elsewhere.

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reforming its construction defects law in 2015, premiums for developers' insurance coverage in the state increased by 300 to 400 percent over the past two decades).

[31] *See* Rebchook, *supra* note 2.

[32] *Id.*

[33] S.B. 17-045, 71st Gen. Assemb., Reg. Sess. (Colo. 2017).

[34] *Id.*

[35] Crisanta Duran, Speaker of the Colorado House of Representatives, House Speaker Remarks on Opening Day of the Seventy-First Colorado General Assembly (Jan. 11, 2017).

[36] S.B. 17-045, 71st Gen. Assemb., Reg. Sess. (Colo. 2017).

[37] Duran, *supra* note 35.

[38] COLO. REV. STAT. § 13-20-801 (2016).

IV. CONCLUSION

Colorado should allow for arbitration of a construction defect claim regardless of whether the association later amends the governing documents. Colorado's condo shortage will continue until either the legislature amends the CCIOA to allow for mandatory arbitration or the Colorado Supreme Court upholds the *Vallagio* decision. Because most residents are being priced-out of single-family homes, condos are a person's only affordable housing option. With the condo shortage, this is not an option. The legislature must act now and create acceptable options for current homeowners, future homeowners, and developers alike. Mandatory arbitration is the answer to Colorado's condo shortage.

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