

Supreme Court No. 80480-0

SUPREME COURT OF THE STATE OF WASHINGTON

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STATE OF WASHINGTON
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BLAKELEY COMMONS CONDOMINIUM ASSOCIATION

Respondent,

v.

BLAKELEY COMMONS LLC

Petitioner

BRIEF OF RESPONDENT

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I. INTRODUCTION

This matter involves claims by one Washington Corporation pursuing claims against another corporation for statutory claims made under the Washington Condominium Act and Consumer Protection Act.

The Blakely Commons Condominium Association, LLC is a Washington non-profit corporation composed of owners of 104 condominium units, common elements, and limited common elements located in Seattle, Washington. Blakeley Village LLC was the developer for the Blakeley Commons Condominiums (the "project"). The Association never signed any agreement or contract to arbitrate any dispute with Blakely Village LLC.

After moving into the project, the Association began noticing problems within its building. In the winter of 2005, SIR Construction conducted an investigation of the project and drafted a comprehensive report detailing the defects at the project. Shortly thereafter, the association retained the services of Interface Management to confirm the defects located and identified in SIR Construction's report. On April 28, 2005, Respondent served the Petitioner with a letter authored by Respondent's attorney in addition

to the two comprehensive expert reports identifying construction defects at the project. Neither of these reports identified a defective product but rather only identified workmanship and/or design problems.

On January 30, 2006 the Association filed a lawsuit against the petitioner for breach of implied warranties, breach of express warranties, breach of contract, breach of the Washington Condominium Act, violation of the Washington Consumer Protection law, breach of fiduciary duty, and misrepresentation. Shortly thereafter, the petitioner moved for arbitration and to stay all proceedings pending resolution of the Satomi matter, arguing the issues were identical. On August 17, 2007, the stay was lifted and the court ruled the Association could proceed to trial with its WCA claims and that all of the breach of contract claims were subject to the arbitration agreement contained in purchase and sale agreements.

The trial court, relying on the Court of Appeals decision in *Satomi Owners Ass'n v. Satomi LLC*, 139 Wn.App. 175 (2007), correctly decided that the Federal Arbitration Act (9 U.S.C. § 2) does not require arbitration of the WCA claims or the CPA claims.

II. COUNTERSTATEMENT OF ISSUES

- A. Does the FAA preclude judicial remedies for Washington Condominium Act claims?
- B. Do arbitration agreements entered into by original condominium purchasers bind a condominium association that is not a party to the agreements?
- C. Is a unilateral arbitration provision unconscionable?

III. ARGUMENT

- A. **The Court of Appeals analysis in *Satomi* is correct.**

In the *Satomi Owners Assoc. v. Satomi LLC*, 139 Wn.App 175 (2007) Division One of the Court of Appeals correctly held that the Federal Arbitration Act does not implicate the Washington Condominium Act and Consumer Protection Act claims asserted by the condominium owner association. For the purposes of this case, the arbitration provision between the sellers and the purchasers is identical.

The Federal Arbitration Act (the "FAA") provides, in part:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy

thereafter arising out of such contract or transaction. . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2. To compel arbitration under the FAA the Petitioner "must make a threshold showing that a written agreement to arbitrate exists and that the contract at issue involves interstate commerce." *Maxum Found., Inc. v. Salus Corp.*, 779 F.2d 974, 978 n. 4 (4th Cir. 1985).

The analysis of whether a transaction involves commerce is not whether the companies or individuals involved affect commerce.¹ Rather, the analysis focuses on whether the contract containing the arbitration clause affects interstate commerce.

This case involves litigation between two Washington corporations involving real property developed, and designed and constructed by Washington entities. The Court of Appeals in *Satomi* correctly held that the Warranty Addendum does not affect interstate commerce.

In this case, the "contract at issue" containing the arbitration clause is the Warranty Addendum. The Petitioner had the burden of proving that the Warranty Addendum, not simply the business of

¹ Whether a written agreement exists is discussed in Sec. B, *infra*.

constructing condominiums, involves interstate commerce. The

Court of Appeals clarified this distinction:

Where the issue is federal regulation of the business itself – for example, enforcement of the rights of employees to nondiscriminatory and healthy workplaces – the “transaction” involves the internal operation of the business, and its use of materials shipped in interstate commerce is enough to characterize that business as affecting commerce for the purposes of the FAA. . . . Where the issue is a private dispute, however, the analysis must identify the transaction involving interstate commerce.

Satomi, 159 P.3d at 468.

Despite the recitation by Petitioner regarding the “interstate” nature of some of the materials used in the construction, the terms of the contract do not evidence interstate commerce. Because the legal focus is upon *the contract* containing the arbitration clause, it is necessarily fact-based and not a pure question of law. Moreover, “real property law has historically been the law of each state” and the warranties in question here specifically derive from state law. *Id.* There is simply not enough interstate connection that would justify compelling arbitration under the FAA, depriving Washington citizens of their judicial remedies.

In contrast to the issues of federal control analyzed in *Citizens* and *Allied-Bruce*, in this case the mere fact that some materials (even defective materials) may have traveled through interstate commerce is not enough to "represent a general practice subject to federal control." The issue is whether the petitioner violated its warranty that the materials and workmanship had been inspected and were of sound quality and suitable for the use to which they were put. Likewise, there is no issue relating to the method, manner, or quality of financing.

Further, counsel for respondent is unaware (as was the court in *Satomi*) of any court that has held that the use of materials (or money) from other states, by itself, renders a private transaction as one "involving interstate commerce." To do so in today's market would subject virtually every transaction to federal control under the Commerce Clause.

B. The Association is not bound by the arbitration agreements entered into by its individual members.

It is fundamental to interpretation of arbitration agreements that there first be a written agreement, either under the Federal

Arbitration Act or the Washington arbitration statute. See 9 U.S.C. § 2; RCW 7.04. To compel arbitration under the FAA, the Petitioner must make a "threshold showing that a written agreement to arbitrate exists and that the contract at issue involves interstate commerce." *Maxum Found, Inc. v. Salus Corp.*, 779 F.2d 974, 978 n. 4 (4th Cir. 1985). See also, *Powell v. Drake*, 87 Wn.App. 890, 898 (1999) ("parties to a dispute will...not be compelled to arbitrate unless they have agreed to do so.")

In this case, there is no written arbitration agreement between the Petitioner and Respondent. Rather, the Petitioner relies on individual agreements entered into by individual unit owners.

1. *An individual homeowner cannot bind the Association to an arbitration agreement.*

It is undisputed that the Respondent Association is not a party to either the purchase and sale agreements or the Warranty Addenda which contain the disputed arbitration provisions. Rather, the Petitioner relies on documents signed by original unit purchasers.

The Petitioner provides no support for its argument that an individual member of a homeowner association can bind the Association or waive its statutory rights. Pursuant to RCW 64.34.328,

the Association has the exclusive right and obligation to maintain, repair, and replace common and limited common elements. RCW 64.34.304 empowers the Association to "[i]nstitute, defend, or intervene in litigation...in its own name on behalf of itself or two or more unit owners on matters affecting the condominium." RCW 64.34.304(d). This is an independent, statutorily created right and is not in the control of any individual unit owner.

Neither at the time of the purchase of their units, nor today, are the individual unit owners the agents of the Association. Therefore, the individual homeowners have no authority to bind the Association to the addendum buried within the purchase and sale documents or for that matter any other contract. *Barker v. Skagit Speedway, Inc.*, 119 Wn.App 807 (2003). The Petitioner has not, nor could it, provide any evidence to this Court that the Association consented to an agency relationship in which its individual members could bind it to a contract. As the Association was not a party to the contract it cannot be bound to the agreement to arbitrate.

The Petitioner's argument that the Association does not have the statutory right to pursue claims that affect the limited and common

elements of at Blakeley defies logic and the express provisions of the Washington Condominium Act. The individual unit owners of a condominium only have control over the interior of their units and the Association has control over and is responsible for the limited common element and common elements of the project. See RCW 64.34.304. The WCA specifically states the association has a duty to each owner to, "regulate the use, maintenance, repair, replacement, and modification of common elements." See RCW 64.34.304(f). Furthermore under RCW 63.34.304(d), the Association has the right to institute, defend, or intervene in litigation or administrative proceedings in its own name on behalf of itself. RCW 64.34.328.

Although the Petitioner argues that the Association only sues in a derivative capacity, it cites no applicable Washington law to this effect.² In fact, the Association's rights are derived not from the Limited Warranty or the purchase and sale agreement. Rather, the claims arise from the language in the Washington Condominium Act that provides the Association with its own legal status.

² *Stuart v. Coldwell Banker*, 109 Wn.2d 406, 414 (1987), cited by the Petitioner, is inapplicable. In that case (brought under the former Washington Condominium Act), the association was not incorporated and therefore "had no life independent of the individual homeowners." In this case, the Respondent is a separate, legally

2. *The secondary purchasers did not agree to arbitration.*

Further, the Petitioners have presented no evidence that the secondary purchasers of condominium units agreed to arbitration of any of their claims. The WCA clearly provides rights to secondary purchasers. See e.g. RCW 64.34.445. Since the project has been completed and the Petitioner sold all the units at the project, multiple owners who purchased their homes from the Petitioner have resold their units. These secondary purchasers obviously did not sign an agreement with the defendant agreeing to arbitration. Their rights do not flow from any contract with the Petitioner. Rather, their rights arise by operation of statute. See e.g. RCW 64.34.445(6).³

Section 10 of the Addendum states that

If the purchaser sells the unit at any time within the four years after closing of the sale of the unit from Seller to Purchaser, or Purchaser's taking possession of the unit, whichever is later Purchaser shall notify of the sale in writing and shall include in the signed purchase and sale agreement providing such sale a provision that the persons purchasing the Unit agree that any warranty rights of such person(s) relating to the Unit or Common Elements are limited to this Purchaser's rights under this Warranty at the time of such sale. If Purchaser fails

incorporated entity and brings the action in its own name with respect to its own rights and obligations.

³ The *Satomi* court erroneously dismissed this argument out of hand without any authority or discussion.

to comply with this Paragraph, Purchaser shall indemnify, defend and hold harmless Seller from and against all damages, costs, attorney fees and expenses caused by such failure.

Petitioner's warranty addendum calls for original purchasers to indemnify the Petitioner if the original purchasers sell a unit without putting subsequent purchasers on notice of the limited warranty. This language seems to accept the general proposition that arbitration clauses cannot be imposed on future purchasers and provides a remedy. Therefore, if Petitioner is entitled to any form of indemnity from a first purchaser for a claim brought against Petitioner for breach of warranties of quality under the WCA or the limited warranty they provided to the first purchaser, it has an independent responsibility to seek that indemnity from the original homeowners.

3. *The Petitioner did not demonstrate that all original purchasers agreed to arbitration.*

The Petitioner has not, by its own admission, presented evidence that every original purchaser agreed to arbitration. In fact, Petitioner admits that at least three arbitration agreements "cannot be found." (CP 13-14). Under no circumstance should an arbitration agreement be presumed when it cannot be produced.

C. The Arbitration agreement is unenforceable because it is substantively and procedurally unconscionable, and is illusory.

As discussed above, the Respondent maintains that the Federal Arbitration Act is not implicated because the sale of the condominium units to individual purchasers does not impact interstate commerce. For purposes of this section, assuming *arguendo* that the FAA does apply, the arbitration agreement is still unenforceable because it violates the law of contracts.

The United States Supreme Court has clearly stated that state law is not preempted and is applicable if the "law arose to govern issues concerning the validity, revocability, and enforceability of contracts, generally." *Perry v. Thomas*, 482 U.S. 483, 492 n. 9 (1987); see also *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

Washington courts have recognized two categories of unconscionability - substantive and procedural. *Schroeder v. Fageol Motors, Inc.*, 86 Wn.2d 256, 260 (1975). "Substantive unconscionability involves those cases where a clause or term in the contract is alleged to be one-sided or overly harsh." *Id.* Procedural unconscionability is "the lack of meaningful choice, considering all the

circumstances surrounding the transaction, including "[the manner in which the contract was entered," "whether each party had a reasonable opportunity to understand the terms of the contract," and whether "the important terms [were] hidden in a maze of fine print." *Zuver v. Airtouch Communications, Inc.* 153 Wn.2d 293, 303 (2004). General provisions of unconscionability may be applied to void arbitration agreements without violating the Federal Arbitration Act. *Doctors Assoc's.v. Cassorotto*, 517 U.S. 681, 687 (1996).

To determine whether an adhesion contract exists (i.e. a procedurally unconscionable contract), the Court considers "(1) whether the contract is a standard form printed contract, (2) whether it was 'prepared by one party and submitted to the other on a "take it or leave it" basis', and (3) whether there was 'no true equality of bargaining power' between the parties." *Yakima County (W. Valley) Fire Prot. Dist. No. 12 v. City of Yakima*, 122 Wn.2d 371, 393 (1993).

The Warranty Addendum is clearly a contract of adhesion, and qualifies as procedurally unconscionable. The Petitioner admits that

it was Blakely Village, LLC's standard practice to require signed warranty addendums as a prerequisite to completing the sales transactions for each of the units at the project. The transaction for the sale of

each unit would not have been completed without a signed warranty addendum.

(CP 14). Clearly this was a "take it or leave it" contract forced upon prospective purchasers.

The arbitration provision is substantively unconscionable as well. The clause at issue states:

Seller's Right to Arbitrate. At the option of Seller, Seller may require that any claim asserted by purchaser or by the Association under this warranty or any other claimed warranty...must be decided by arbitration....

This provision is unilateral, in that it gives the Seller the sole and exclusive option to decide whether any disputes will be resolved through arbitration. This provision is substantively unconscionable because it is one-sided. It requires purchasers to give up their rights to a judicial remedy "at the option of Seller." However, the Seller retains all rights to a judicial remedy for any claims it may have. See *e.g. Zuver v. Airtouch Communications, Inc.* 153 Wn.2d at 318-319 (holding that unilateral arbitration provision with respect to claims that may be arbitrated is so one-sided as to render it patently "overly harsh.>").

Further, the arbitration provision is also unenforceable because it lacks mutuality making it illusory and unenforceable. See *Metro Park Dist. Of Tacoma v. Griffith*, 106 Wn.2d 425, 434 (1986).

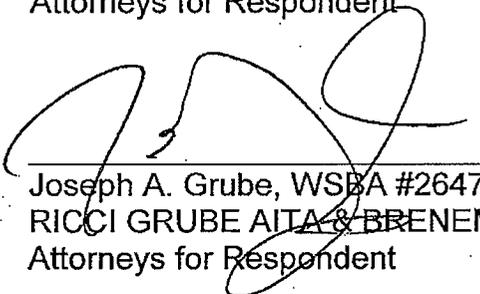
IV. CONCLUSION

This is a private dispute between two Washington corporations involving real property located in the State of Washington, built by Washington corporations, involving breaches of the Washington Condominium Act and the Washington Consumer Protection Act. The petitioners have presented no evidence that the substance of the WCA claims affect or involve interstate commerce to invoke preemption via the Federal Arbitration Act. The *Satomi* court (and the trial court in this case) correctly held that the breach of contract claims are not subject to arbitration and that the Association is entitled to a jury trial on its Washington Condominium Act and Consumer Protection Act claims.

Respectfully submitted this 14th day of January, 2008.



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