CHAPTER 22: THE LAW OF HOMEOWNERS' ASSOCIATIONS

OVERVIEW

Litigation involving Homeowners' Associations (HOA) is a very diverse and unpredictable area of law. Typically, the litigants are emotionally invested in the suit and tend to make decisions based on emotions rather than logic and objectivity. Also, they often represent themselves *pro se* or have been able to induce a family member or family friend to represent them. This compounds the emotionally charged atmosphere because litigants are not receiving unbiased counsel on the issues.

The most common situation giving rise to a lawsuit against an HOA is when an HOA denies a plaintiff's application for a variance on their property which would allow them to construct (or keep) a prohibited element. Such variance requests can range from paint color, to the placement or height of a perimeter wall or trees, and structures that block a neighbor's view. With these types of claims, plaintiff usually claims to be singled out and treated differently than other neighbors. Not surprisingly, many of these claims arise soon after a vote by the HOA Board to change previous CC&R's and enact new rules that restrict or eliminate a previously enjoyed right. In addition, litigation can arise from an HOA's failure to comply with its rules and regulations, or to act reasonably.

In ***Kalway v. Calabria Ranch HOA, LLC***, 252 Ariz. 532, 506 P.3d 18 (2022), the Arizona Supreme Court held that an HOA may rely on a general-amendment-power provision in its covenants, conditions, and restrictions ("CC&Rs") to restrict homeowners' use of their property only with respect to those restrictions for which the HOA's original declaration provided sufficient notice. Allowing substantial, unforeseen, and unlimited amendments, said the court, would alter the nature of the covenants to which the homeowners originally agreed. In *Kalway*, the general-purpose statement in Calabria Ranch's original declaration--to "protect[ ] the value, desirability, attractiveness and natural character of the Property"--was too broad and subjective to give notice of future amendments. Below is a general discussion of the basics of HOA formation and regulation.

FORMATION AND REQUIREMENTS

Membership

HOAs fall into one of two categories: condominiums, where homeowners share proportionally in the ownership of common areas; or planned communities, where the HOA itself owns the common areas. The difference is important with regard to which law will apply to the homeowners and the HOA.

Arizona law defines an association as "a nonprofit corporation or unincorporated association of owners that is created pursuant to a declaration to own and operate portions of a planned

community and that has the power under the declaration to assess association members to pay the costs and expenses incurred in the performance of the association's obligations under the declaration." A.R.S. § 33-1802(1). A "planned community" is a "real estate development which includes real estate owned and operated by a nonprofit corporation or unincorporated association of owners, created for the purpose of managing, maintaining or improving property, and in which the owners of separately owned lots, parcels or units are mandatory members and are required to pay assessments to the association for these purposes. A.R.S. § 33-1802(4).

Since HOAs are nonprofit corporations, its articles of incorporation or bylaws may establish the procedures for new and continued membership in the HOA. *See* A.R.S. § 10-3601(A). A person cannot be admitted as a member without that person's express or implied consent to membership. A.R.S. § 10-3601(B). Implied consent occurs through ownership of a lot or unit in the community, and constructive notice of mandatory membership occurs because of recorded declarations. Members may resign at any time, unless the articles of incorporation or bylaws require all owners to be mandatory members of the nonprofit corporation/association.

A member may be expelled or suspended, under A.R.S. § 10-3621, according to a procedure set forth in the articles of incorporation or the bylaws, by an agreement between the association and member, or by a procedure that is "otherwise appropriate." "Otherwise appropriate" procedures are valid only if: (1) a written notice stating the reasons is provided to the member at least 15 days before the expulsion, suspension or termination; (2) an opportunity for the member to be heard, orally or in writing, at least five days before the effective date of the expulsion, suspension or termination by a person or persons authorized to decide that the proposed expulsion, suspension or termination should not take place is provided to the member; and (3) the termination, expulsion or suspension is fair and reasonable taking into consideration all of the facts and circumstances. All written notices must be sent to the member's last address shown in the association's records, and the member has six months to file a lawsuit challenging the action. Suspension does not relieve a member from obligations for dues, or fees assessed that resulted before the suspension. These "otherwise appropriate" procedures come into play only if there are no procedures set forth in the articles of incorporation or bylaws.

General Powers

Unless limited by the articles of incorporation, the HOA has perpetual duration and the same powers as individuals to do all things necessary or convenient to carry out its affairs. A.R.S. § 10-3302 lists the powers that nonprofit corporations such as community associations possess. Those applicable to community associations include: (1) sue and be sued, complain and defend in its corporate name; (2) purchase, receive, lease or otherwise acquire and own, hold, improve, use and otherwise deal with real or personal property or any interest in property wherever located; (3) sell, convey, mortgage, pledge, lease, exchange and otherwise dispose of all or any part of its property; (4) make contracts and borrow money and the power to secure its obligations by mortgage or other encumbrance of its property or income; (5) impose dues, assessments, admission and transfer fees on its members; and (6) do any other act not inconsistent with law that furthers the activities and affairs of the corporation.

In ***Sycamore Hills Estates Homeowners Association, Inc. v. Zablotny***, 250 Ariz. 479, 481 P.3d 705 (Ct. App. 2021), the court of appeals rejected the HOA's argument that two-year-old a settlement

agreement it had entered into with a homeowner, Zablotny, was invalid because the HOA did not "have authority" under the CC&Rs to enter into it. In the settlement agreement, the HOA had affirmed that "[t]he individual(s) who have signed this Agreement on behalf of their respective entities hereby certify that they have the right and full corporate authority to enter into this Agreement on behalf of their entities." Moreover, A.R.S. § 10-3304(A) states that "[e]xcept as provided in subsection B of this section, the validity of the corporate action shall not be challenged on the ground that the corporation lacks or lacked power to act." Subsection B states that only a member can bring such a challenge, and the Association was not a "member." *Id*. at 484-85.

Meetings and Voting

Meetings must take place at least once per calendar year. They may be called by the president, a board majority, or 25% of the voting members. Notices for annual, regular, or special meetings must be provided to those members entitled to vote at least 10 days, but not more than 60 days before the meeting in compliance with the Arizona Condominium Act and planned community statutes. A.R.S. § 10-3706 allows a member to waive the notice of a meeting by signing a document and delivering it for inclusion in the minutes or filing it in the records. Notice must be hand delivered or delivered via US mail. For meetings of the board of directors, only 48-hour notice is necessary.

All meetings of the association must be open to all members. There are four specific exceptions to the open meeting requirement, where the board may close the meeting to the executive section. These exceptions are: (1) when receiving advice of legal counsel; (2) when discussing pending or potential litigation; (3) when personal, health, or finance issues are discussed with respect to an individual member; and (4) when discussing matters related to job performance, health, compensation, or complaints directed against any individual working for the association or under the direction of the association.

Unless otherwise provided by the articles of incorporation or bylaws, all members of the HOA will have the same rights and obligations with respect to all matters. A.R.S. § 10-3610. The articles or bylaws may establish classes of membership with different rights or obligations (e.g., weighted voting for single-family residence owners compared to townhouse unit owners).

A quorum of members must be present, in person or by proxy, at a membership meeting in order to conduct business. If the articles of incorporation or bylaws do not state what constitutes a quorum, the default is 10% of eligible voters. A.R.S. § 10-3722. If a quorum is established, the vote of the majority will constitute an action of the members at large. A.R.S. § 10-3723. The only time proxies are permitted in community associations is during the period of declarant control. A.R.S. §§ 33-1250, 33-1812.

Assessments and Dues

Homeowners pay assessments of the HOA on a monthly, quarterly or annual basis. Money paid by a homeowner must first be applied to the principal of the assessment and then to late charges and penalties. HOA's must provide a written statement of unpaid assessments within 15 days of a homeowner's request in writing. HOA's can only foreclose on a home if the owner is at least

one year overdue on assessments, or he/she owes $1,200 or more, excluding reasonable collection fees, attorney's fees, and late fees.

Special Requirements for Condominium Units (A.R.S. 33-1201 et seq.)

Condominiums are governed by the Arizona Condominium Act, codified at A.R.S. § 33-1201 through § 33-1270. Arizona law allows a condominium to be created by the recording of a declaration. A.R.S. § 33-1211. This declaration is commonly referred to as the Covenant, Conditions and Restrictions (CC&R's) of the association. This declaration must be indexed in the name of the condominium, the association, and as required by law. The declaration may contain any matter the "declarant" deems appropriate. A.R.S. § 33-1215. A.R.S. § 33-1217 controls the voting rights for condominium units. It establishes that the declaration is not required to, but *may* provide that: (1) varying allocations of votes be made dependent on matters indicated in the declaration; (2) cumulative voting is allowed when electing members of the board of directors only; and (3) class voting is allowed on specific issues that affect the class if necessary to protect valid interests of the class.

LIABILITY

Breach of Contract

Deed restrictions limiting development to "residential" development are enforceable in Arizona. ***Cont'l Oil Co. v. Fennemore***, 38 Ariz. 277, 299 P. 132 (1931) (deed restrictions may be enforced in equity by any of the grantees against the others when "as a part of a general scheme of improvement restrictions are inserted in all of the deeds governing the purposes for which the land may be used.").

Other contract documents produced by HOAs include articles of incorporation, bylaws, and a declaration of covenants, conditions and restrictions (most commonly referred to as CC&R's). The HOA can also adopt rules that interpret the CC&R's or bylaws.

HOAs can levy fines for the violation of a rule. Fines cannot be used to form the basis of a foreclosure action. To collect the fines, a homeowner must either voluntarily pay the fine, or the HOA must file a lawsuit to collect. HOAs must first offer the homeowner a hearing with the board of directors before issuing a fine. If no hearing is given or offered, the fine is not enforceable.

DERIVATIVE ACTIONS

Derivative actions are civil suits brought by members in "the right of the corporation." A.R.S. §§ 10-3630 to 10-3637 address derivative suits. Members having 25% of the voting power, or 50 members, whichever is less, can bring an action in superior court to procure a judgment in favor of the association. The provisions of these statutes are procedural and dictate when an action can be commenced and what must be done for the action to be dismissed.

DAMAGES

Contract Damages

Restrictive covenants are enforceable as contracts. When a grantee accepts a deed containing restrictions, he assents to them and is bound to perform them. ***Heritage Heights Home Owners Ass'n v. Esser***, 115 Ariz. 330, 333, 565 P.2d 207, 210 (Ct. App. 1977).

Enforcement of restrictive covenants is governed by equitable principles. An injunction is an equitable remedy that allows the court to promote equity between the parties. ***Ahwatukee Custom Estates Mgmt. Ass'n Inc. v. Turner***, 196 Ariz. 631, 2 P.3d 1276 (Ct. App. 2000).

Equitable Estoppel

Plaintiffs seeking equitable relief must have "clean hands" when attempting to enforce restrictive covenants in Arizona. ***McRae v. Lois Grunow Mem'l Clinic***, 40 Ariz. 496, 14 P.2d 478 (1932). A plaintiff can be estopped from enforcing the covenants and receiving equitable relief if she does not have "clean hands," and if her conduct would make it unjust to grant her relief. *McRae*. A person may, however, be entitled to enforce a restrictive covenant even though she has been on notice of violations inflicting no substantial injury. ***Whitaker v. Holmes***, 74 Ariz. 30, 243 P.2d 462 (1952). The right to enforce will not be lost by failing to take steps to restrain innocuous violations when the violation in a particular case causes substantial injuries. *Whitaker*.

A "change in circumstances" or "change in use" can also negate enforceability of restrictive covenants. If the use to which property in a neighborhood is being put is such that it is no longer residential property, it would be inequitable to allow restrictions where the changed condition did not result from a breach, but from other causes. ***Cont'l Oil Co. v. Fennemore***, 38 Ariz. 277, 299 P. 132 (1931). If the surrounding area is so fundamentally changed as to frustrate the original purposes of the restrictions, equity will not enforce them. ***Murphey v. Gray***, 84 Ariz. 299, 327 P.2d 751 (1958). Permitting frequent violations may also cause the restrictive covenants and neighborhood scheme to be considered abandoned. ***O'Malley v. Cent. Methodist Church***, 67 Ariz. 245, 195 P.2d 444 (1948). Violations of separate and unrelated covenants cannot be used to show a "waiver" of a different restrictive covenant at issue, however. The violations must be of "a character and extent to indicate an abandonment of the entire restrictive plan." ***Condos v. Home Dev. Co.***, 77 Ariz. 129, 267 P.2d 1069 (1954).

Express non-waiver provisions can be used in restrictive covenants. These provisions can aid in gaining injunctions and enforcing the covenants. An express non-waiver provision cannot be overcome if a complete abandonment of the entire restrictive covenant occurs. ***Burke v. Voicestream Wireless Corp. II***, 207 Ariz. 393, 87 P.3d 81 (Ct. App. 2004). Absent a complete abandonment, the provision will be enforced according to its terms. *See Burke*.

ATTORNEY'S FEES

The prevailing party is entitled to a mandatory award of attorney's fees and costs in an action to foreclose on a lot or unit for unpaid assessments. A.R.S. § 33-1256. Most CC&R's also state that the lien and personal obligation come with reasonable attorney's fees.

If the statutory requirement is embodied in the deed restrictions, the court must abide the contract as long as the restriction is valid. A provision stating that a community that hires an attorney is entitled to "all" of its attorney's fees, and similar provisions, will not be enforced to authorize unreasonable or clearly excessive attorney's fees. *See* ***McDowell Mountain Ranch Cmty. Ass'n, Inc. v. Simons***, 216 Ariz. 266, 165 P.3d 667 (Ct. App. 2007).

If you have questions regarding the information in this chapter, please contact the author or any JSH attorney.

CONTRIBUTING AUTHOR:

GARY LINDER, PARTNER For nearly 20 years, Gary Linder has focused his defense practice primarily in the areas of civil and tort/negligence. He represents officers and directors in matters involving professional liability, construction defect, auto and aviation product liability, and wrongful death and personal injury. Gary also maintains a significant dram shop practice, and has handled more than 100 dram shop cases in almost every populated county in Arizona. His experience in this area includes any type of claim that could arise under a policy issued to a bar or restaurant, including premises liability, and assault and excessive force claims.

glinder@jshfirm.com | 602.235.7106 | jshfirm.com/glinder