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Red Light – Green Light: When CC&Rs Give HOAs the Go Ahead to Sue

Whenever a homeowners' association (Hereinafter HOA) sues, a preliminary analysis must determine whether the HOA has standing to proceed.

This determination will entail researching the type of claims being made and whether they involve common areas maintained by the HOA or damage to areas which are exclusive to the individual unit owners, as discussed in the covenants, conditions & restrictions (CC&Rs). In addition, the CC&Rs and association minutes will disclose any meeting and voting requirements which must be met before the HOA is allowed to initiate a claim or suit. Finally, any prior claims by individual unit owners should be researched as there may be claims preclusion.

A developer may have standing to challenge the adequacy of the procedure underlying commencement of a civil action.

According to many Developers, prior litigation against them by some individual homeowners precluded the HOA's subsequent claims under the principles of res judicata or collateral estoppel. However, courts will usually reject that argument if the HOA was not a party to that litigation. See, e.g., *Boeken v. Philip Morris (2010)* 48 Cal.4th 788.

In addressing the manner in which the HOA could pursue construction defect (CD) litigation against the Developer, some CC&Rs provide:

> A resolution authorizing the Board to commence a lawsuit must be approved by Members representing more than 50% of their total voting power …. The related notice before such an approval must state:
>
> (1) Estimated attorneys' fees and costs, and their funding;
>
> (2) The lawsuit's likely benefits and adverse consequences,
>
> including the potential effect upon the Project's real estate values; and
>
> (3) Any offers of settlement by the Developer.

In order to proceed with such a lawsuit, the Developer contended that the CC&R requirements must be satisfied before proceeding in a civil lawsuit.

Many CC&Rs require meetings regarding civil actions; requirements for commencing or ratifying certain civil actions; right of units' owners to request dismissal of certain civil actions; disclosure of terms and conditions of settlements similar to the following;

1. The association shall provide written notice to each unit's owner of a meeting at which the commencement of a civil action is to be considered at least 21 calendar days before the date of the meeting. Except as otherwise provided in this subsection, the association may commence a civil action only upon a vote or written agreement of the owners of units to which at least a majority of the votes of the members of the association are allocated. The provisions of this subsection do not apply to a civil action that is commenced:

(a) To enforce the payment of an assessment;

(b) To enforce the declaration, bylaws or rules of the association;

(c) To enforce a contract with a vendor;

(d) To proceed with a counterclaim; or

(e) To protect the health, safety and welfare of the members of the association. If a civil action is commenced pursuant to this paragraph without the required vote or agreement, the action must be ratified within 90 days after the commencement of the action by a vote or written agreement of the owners of the units to which at least a majority of votes of the members of the association are allocated. If the association, after making a good faith effort, cannot obtain the required vote or agreement to commence or ratify such a civil action, the association may thereafter seek to dismiss the action without prejudice for that reason only if a vote or written agreement of the owners of the units to which at least a majority of votes of the members of the association are allocated was obtained at the time the approval to commence or ratify the action was sought.

2. At least 10 days before an association commences or seeks to ratify the commencement of a civil action, the association shall provide a written statement to all the units' owners that includes:

(a) A reasonable estimate of the costs of the civil action, including reasonable attorney's fees;

(b) An explanation of the potential benefits of the civil action and the potential adverse consequences if the association does not commence the action or if the outcome of the action is not favorable to the association; and

(c) All disclosures that are required to be made upon the sale of the property.

3. No person other than a unit's owner may request the dismissal of a civil action commenced by the association on the ground that the association failed to comply with any provision of this section.

4. If any civil action in which the association is a party is settled, the executive board shall disclose the terms and conditions of the settlement at the next regularly scheduled meeting of the executive board after the settlement has been reached. The executive board may not approve a settlement which contains any terms and conditions that would prevent the executive board from complying with the provisions of this subsection.

A nonmember developer may challenge whether a homeowners' association may properly institute against the developer a constructional defect action in a representative capacity on behalf of owners of units in a common-interest community but cannot challenge the internal procedures followed by a homeowners' association in determining to institute the civil action. *D.R. Horton, Inc. v. Eighth Judicial Dist. Court*, 2009, 215 P.3d 697, 125 Nev. 449, rehearing denied.

Nonmember developer had standing to challenge whether a homeowners' association could properly assert claims in a representative capacity on behalf of its members; while statute governing common-interest communities prohibited a nonmember from challenging adequacy of procedure underlying commencement of a civil action, nothing in statute prohibited a developer from challenging whether association met the requirements for bringing a suit in its representative capacity. *Court at Aliante Homeowners Ass'n v. Eighth Judicial Dist. Court*, 2009, 281 P.3d 1164, 2009 WL 3191406, Unreported.

Developer had standing to challenge homeowners' association's ability to raise claims in its representational capacity on behalf of its members for construction defects affecting individual duplex units. *Dorrell Square Homeowners Ass'n v. Eighth Judicial Dist. Court,* 2009, 281 P.3d 1168, 125 Nev. 1032, 2009 WL 3191401, Unreported.

Developer had standing to challenge townhome owners association's ability to raise claims on behalf of its members for construction defects affecting individual units. *High Noon at Arlington Ranch Homeowners Ass'n v. Eighth Judicial Dist. Court*, 2009, 281 P.3d 1181, 125 Nev. 1043, 2009 WL 3191212, Unreported.

An HOA can pursue claims pertaining exclusively to non-common areas by assignment or under circumstances where the HOA has an obligation to maintain or repair those areas or where the damage arises out of a common area.

For example, some CC&Rs state:

> The HOA shall maintain the exterior surfaces of the walls which abut any Individual Owner Lot and which are shown on the Master Declaration or in any Maintenance Area.
>
> Each Lot Owner will maintain the retaining walls between his/her lot and the public walkways.
>
> All structures within the Project not expressly required to be maintained by the HOA shall at all times be maintained by the Lot Owners.

Courts have made determinations about standing based upon the areas damaged and CC&Rs and maintenance manual. The language of the CC&Rs is critical to determining the rights of the HOA and the owners. It is important to analyze the specific language involved. See, e.g., *White v. Dorfman* (1981) 116 Cal.App.3d 892, 897 (evaluation of plaintiff's view obstruction claims).

A plaintiff "must assert his own legal rights and interest, and cannot rest his claim to relief on the legal rights or interests of third parties." *Independent Roofing Contractors v. California Apprenticeship Council* (2003) 114 Cal.App.4th 1330, 1341.

California Civil Code § 1368.3(b) provides that homeowners' associations have standing to sue in their own names as real parties in interest for damage to common areas. As to damage to individual units within the condominium complex ("Separate Interests"), an association has standing to institute litigation in its own name as the real party in interest and without joining the individual owners of the common interest development only when the matter involves damage to a separate interest that: (a) the association is obligated to maintain or repair; or (b) arises out of, or is integrally related to, damage to the common area or separate interest that the association is obligated to maintain or repair. (*See* Civ. Code §§ 1368.3(c) and (d).)

Nevada has some interesting law addressing these issues, specifically NRS 116.3102, which addresses powers of unit owners' associations and limitations on such powers.

1. Except as otherwise provided in this chapter, and subject to the provisions of the declaration, the association:

(d) May institute, defend or intervene in litigation or in arbitration, mediation or administrative proceedings in its own name on behalf of itself or two or more units' owners on matters affecting the common-interest community. The association may not institute, defend or intervene in litigation or in arbitration, mediation or administrative proceedings in its own name on behalf of itself or units' owners with respect to an action for a constructional defect pursuant to NRS 40.600 to 40.695, inclusive, unless the action pertains exclusively to common elements.

- Implicates issues pertaining to class action standing; assignments do not invalidate the HOA's obligation to fulfill the class requirements

- CCR provisions that conflict with above statute no longer invalid

- Significant change from prior case law in NV which allowed HOA broad ability to bring claims both for the common areas as well as the separate.

- *Beazer Homes Holding Corp./View of Black Mountain (Case No. 57187; filed December 27, 2012)* - HOA has standing pursuant to NRS 116.3102(1)(d) and *First Light II* not only to recover damages pertaining to common areas and areas over which they are responsible for maintenance and repair, but also on a purely representative basis; HOA wishing to litigate its members' claims as a class action must demonstrate that it meets the NRCP 23 requirements or provide an alternative method for doing so that achieves the objectives of NRCP 23. This would include providing sufficient detail as to the alleged defects. The Court found that merely contending that all of the claims affect the 'building envelope' is inadequate.

- *High Noon at Arlington Ranch Homeowners Association/D.R. Horton (Case Nos. 58533 and 58630, filed January 25, 2013).* The Nevada Supreme Court ruled that the CC&Rs for the project clearly showed that the 'building envelope' elements are part of the individually owned units, thereby requiring the District Court to perform a "full and thorough NRCP 23 analysis" as required by *First Light II*.

Moreover, the Nevada Supreme Court held that its holding in *First Light II* was not intended to apply only to defects that occur within individual units, but rather to all claims affecting individually owned units that an HOA brings in a representative capacity; Further, the HOA alleged defects regarding the 'fire resistive and structural components' of the units. The District Court conducted and documented a thorough NRCP 23 analysis and found that the HOA failed to meet the NRCP 23(a) commonality and typicality requirements and the NRCP 23(b)(3) predominance and superiority requirements. The Nevada Supreme Court upheld the District Court's determination that the HOA failed to show whether the myriad of constructional defects alleged were typical of those found within the 194 unit's owner's homes. Additionally, the Nevada Supreme Court found that the HOA failed to show that the damage suffered by each of the unit owners was the same and that the use of limited extrapolation data was unfair to both D.R. Horton and any unit owner who suffered additional or different harm; The Nevada Supreme Court further upheld the District Court's finding that the HOA also failed to satisfy the more demanding predominance requirements and failed to show that class action would be the superior method of adjudicating this matter as required by NRCP 23(b)(3).

- *Environment for Living, Inc. et al/Serenity Homeowners Association (Case No. 57515; filed on January 25, 2013)* The Nevada Supreme Court found that the District Court failed to conduct a sufficient analysis with respect to the NRCP 23(b)(3) predominance requirement. The District Court found that the HOA's claims, which were limited to the 'building envelope,' met the predominance requirement of NRCP 23(b)(3). However, the Nevada Supreme Court disagreed in light of the facts of the case. Specifically, the Supreme Court noted that the claims involved 138 different residences in 14 different buildings, constructed over a period of 5 years, pursuant to 2 different building codes, by over 50 subcontractors. Further, the Supreme Court noted that not all of the residences had been inspected and the variances in the defects found in those residences that were inspected did not support an extrapolation of findings to the uninspected residences. Moreover, the Supreme Court noted that the Developers' assertion of contributory negligence as a defense would further necessitate individualized proof. As such Developers' petition was granted and the case was remanded for further proceedings.