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# COMMON INTEREST DEVELOPMENT UPDATE

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December 2008

CASE LAW UPDATE

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A number of reported decisions were issued in 2008 relating to and/or impacting common interest developments.

**A. Fourth La Costa Condominium Owners Association v. Seith (2008) 159 Cal.App.4th 563**

In *Fourth La Costa*, a forty-eight (48) unit association sought an order, pursuant to Civil Code Section 1356, reducing the percentage of affirmative votes needed to amend the association's declaration of covenants, conditions, and restrictions ("CC&Rs"). The association's CC&Rs required that any amendment to the CC&Rs be approved by no less than seventy-five (75%) of the association's members. Prior to moving pursuant to Civil Code Section 1356, the association had asked members to vote on whether to enact restated CC&Rs, and had extended the voting deadline after many owners did not return ballots. The association sought to enact restated CC&Rs because various provisions in the existing CC&Rs, recorded in 1969, had been superceded by changes in the law. Other provisions—such as those pertaining to developer rights and obligations—were no longer applicable.

Ultimately, twenty-five (25) owners voted to enact the restated CC&Rs, eleven (11) voted against it, and twelve (12) did not return ballots. Based on the twenty-five (25) affirmative votes received, the association petitioned the court for an order deeming the restated CC&Rs to have been approved. The court granted the petition.

A homeowner challenged the order granting the petition. The homeowner claimed, among other things, that: (a) the vote on whether to enact the amended

CC&Rs was invalid, since it had been conducted by mail and mail voting was not expressly authorized by the CC&Rs; (b) the association, prior to filing the petition, had not engaged in a "reasonably diligent effort . . . to permit all eligible voters to vote on the proposed amendment," as required by Civil Code Section 1356(c)(3), and (c) the restated CC&Rs improperly changed the vote required for future amendments from a super majority to a majority vote, since the original CC&Rs expressly provided that it "shall not be amended to allow amendments by a vote of less than seventy-five percent . . . of the Owners."

The Court of Appeal rejected each of these contentions. With respect to mail voting, the Court of Appeal found mail voting did not have to be specifically authorized by the CC&Rs because Corporations Code Section 7513(a) permits mail voting unless such voting is specifically "prohibited in the articles or bylaws." The Court of Appeal also found that the association, which had sent three reminders to the membership to vote, had engaged in a reasonably diligent effort to obtain votes from all members. While conceding that it perhaps "would not have been onerous" for the association to have telephoned the twelve (12) members who had not voted, in an effort to engage those members in the voting process, the Court of Appeal found that the Association's "efforts were sufficient" to satisfy its obligation under Section 1356(c)(3). *Id.* at 574.

The Court of Appeal also rejected the plaintiff's argument that the restated CC&Rs improperly changed the number of votes required for future amendments from a supermajority vote to a majority vote. The plaintiff argued that, because the original CC&Rs provided that they "shall not be

amended to allow amendments by vote of less than seventh-five percent” of the owners, the CC&Rs could “never” be amended to allow for a simple majority vote. The Court of Appeal, in upholding the change in the number of votes required for future amendments, found that the new provision was reasonable and noted that “[i]t would be rather absurd to allow the governing documents to restrict an association’s ability to amend the [CC&Rs] in perpetuity, even if, for instance, 100 percent of the owners preferred a majority vote rather than a supermajority vote.” *Id.* at 576.

**B. Harvey v. The Landing Homeowners Association (2008) 162 Cal.App.4th 809**

*Harvey* concerned a resolution passed by an association’s board of directors granting certain owners, who had common area attic space adjacent to their units, the exclusive right to use such common area space. Generally speaking, granting exclusive use of common area to association members requires the affirmative vote of at least sixty-seven percent (67%) of the association’s members (or such other percentage as may be required by the governing documents). Civil Code § 1363.07(a). In this instance, however, the board granted the exclusive use pursuant to Civil Code Section 1363.07(a)(3)(E), which provides that membership approval is not required if: (a) exclusive use of common area is granted to members in order to “transfer the burden of management and maintenance” of that area to the members, and (b) the area “is generally inaccessible and not of general use to the membership at large of the association.”

The plaintiff-homeowner challenged the board’s resolution, claiming that the board lacked the authority to issue the resolution, and that several board members breached their fiduciary duties to the association because they, as members who would receive exclusive use of common area pursuant to the resolution, directly benefitted from the resolution. In upholding the trial court’s grant of summary judgment to the association, the Court of Appeal found that the board’s decision was subject to review under the “judicial deference” standard set forth in the Supreme Court of California’s decision in *Lamden v. La Jolla Shores Clubdominium Homewers Assn.* (1999) 21 Cal.4th 249. As noted by the Court of Appeal, this standard requires courts to defer to a “board’s authority and presumed expertise” in exercising its discretion so long as the board engaged in a “reasonable investigation” and acted “in good faith and with regard

for the best interests of the . . . association and its members.” *Id.* at 820 (citation omitted). Applying this standard, the Court of Appeal had no trouble finding that the board’s decision was not subject to challenge. The Court of Appeal noted that, prior to acting, the Board conducted an investigation regarding members’ use of the area at issue, met with City officials to determine such use complied with building codes, consulted with the association’s insurance broker to determine the impact their proposed action would have on the association’s insurance coverage, required owners seeking to obtain exclusive use of common area to obtain \$1 million in liability coverage, and took a variety of other actions relevant to the propriety and feasibility of the resolution.

With respect to the claim that the board had breached its fiduciary duty, the Court of Appeal found that there was no evidence that any of the directors had a “material financial interest” in the resolution such that they had the burden of proving that the resolution was “just and reasonable” to the association pursuant to Corporations Code Section 7233. The Court of Appeal further found that, even assuming that certain board members were “interested directors,” the “undisputed evidence” established that the board members had “met their burden to show that the ‘transaction’ between the interested directors and the [association] was ‘just and reasonable.’” *Id.* at 825. Additionally, the Court of Appeal noted that a “disinterested majority” of the board had approved use of the common area at issue by certain members, prior to passing the resolution, and that the decision was therefore valid under Corporations Code Section 7233(a)(2).

**C. Mission Shores Association v. Pheil (2008) 166 Cal.App.4th 789**

In *Mission Shores*, a homeowner challenged amendments to CC&Rs, obtained pursuant to Civil Code Section 1356, which: (a) prohibited owners from renting their homes for less than thirty (30) days, and (b) granted the association right to evict tenants for breaching the CC&Rs, and to collect associated attorney’s fees and costs from the landlord-owner. The Court of Appeal upheld the leasing restriction, which the association argued was necessary “to ensure the property would not become akin to a hotel,” and also agreed with the association’s arguments as to why it was appropriate for the association to be able to avail itself of landlord-like remedies with respect to renters. According to the Court of Appeal: (a) associations have

been analogized to landlords for purposes of tort liability, and it was therefore appropriate that, “if an association is held to a landlord’s obligations, it should equally benefit from any rights attributed to the landlord,” (b) tenants should be bound by the CC&Rs to the same extent as homeowners, and associations need to be able to take effective measures to ensure tenants’ compliance with the CC&Rs, in the event that a homeowner fails or refuses to take effective measures to ensure their tenant’s compliance with the CC&Rs, and (c) permitting associations to enforce the CC&Rs against tenants did not violate any public policy. *Id.* at 796-797.

It should be noted that the association in *Mission Shores* had the burden of proving the amendments were reasonable. This was because the Association had sought to enact the amendments pursuant to Civil Code Section 1356, which requires an association to demonstrate, among other things, that the proposed amendments are reasonable. Civil Code § 1356(a)(5). Had the amendments been passed pursuant to the CC&Rs, the amendments would have been presumed to be reasonable under the Supreme Court of California’s decision in *Nahrstedt v. Lakeside Village Condominium Assn, Inc.* (1994) 8 Cal.4th 361. Under *Nahrstedt*, use restrictions in CC&Rs are presumed to be reasonable, and parties challenging such restrictions have the burden of proving that the restrictions “are wholly arbitrary, violate a fundamental public policy, or impose a burden on the use of the affected land that far outweighs any benefit.” *Id.* at 382.

**D. Treo@Kettner Homeowners Association v. Superior Court (2008) 166 Cal.App.4th 1055**

The Court of Appeal held in *Treo* that a provision in CC&Rs requiring disputes between the developer and the association be resolved by judicial reference was unenforceable.

The association at issue in *Treo* sued the developer for alleged construction defects. The developer responded by moving the court for an order requiring the association’s claims to be resolved by judicial reference, pursuant to the CC&Rs and Code of Civil Procedure Section 638. In a judicial reference, a pending court action is sent to a referee for hearing, resulting in the claims being resolved by the referee, as opposed to by a jury. Code of Civil Procedure Section 6 provides that courts may order matters resolved by judicial reference “upon the motion of a party to a The

association at issue in *Treo* sued the developer for alleged construction defects. The developer responded by moving the court for an order requiring the association’s claims to be resolved by judicial reference, pursuant to the CC&Rs and Code of Civil Procedure Section 638. In a judicial reference, a pending court action is sent to a referee for hearing, resulting in the claims being resolved by the referee, as opposed to by a jury. Code of Civil Procedure Section 6 provides that courts may order matters resolved by judicial reference “upon the motion of a party to a written contract . . . that provides that any controversy arising therefrom shall be heard by a referee . . . ”

The CC&Rs clearly required any disputes between the developer and the association to be resolved by judicial reference. The judicial reference provision in the CC&Rs was in capital letters and was entitled “AGREEMENT TO DISPUTE RESOLUTION; WAIVER OF JURY TRIAL.” The trial court found that, under the CC&Rs, the association’s construction defect claims were subject to judicial reference and referred the claims to a referee pursuant to Code of Civil Procedure Section 638.

The Court of Appeal reversed the trial court. According to the Court of Appeal, in certain circumstances CC&Rs— which are defined as equitable servitudes pursuant to Civil Code Section 1354(a)— can be construed as contracts. However, the Court of Appeal found that it did not believe that the Legislature intended for Code of Civil Procedure Section 638 to apply to CC&Rs. According to the Court of Appeal: “Treating CC&Rs as a contract such that they are sufficient to waive the right to a trial by jury does not comport with the importance of the right waived. CC&R’s are notoriously lengthy, are adhesive in nature, are written by developers perhaps years before many owners buy, and often, as here with regard to the waiver of trial by jury, cannot be modified by the association.” *Id.* at 1067. Because the CC&Rs were not a “written contract” within the meaning of Code of Civil Procedure Section 638, the Court of Appeal concluded, the trial court erred in referring the claims to a referee.

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