AN UNREASONABLE EXPECTATION: DEFINING "SUFFICIENT NOTICE" IN AMENDING DECLARATIONS OF COVENANTS, CONDITIONS & RESTRICTIONS

Edward Gao

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AN UNREASONABLE EXPECTATION: DEFINING "SUFFICIENT NOTICE" IN AMENDING DECLARATIONS OF COVENANTS, CONDITIONS & RESTRICTIONS

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Abstract

*In its March 22, 2022 ruling in Kalway v. Calabria Ranch HOA, LLC, the Arizona Supreme Court imposed a new rule for community associations seeking to amend their Declarations of Covenants, Conditions, and Restrictions ("CC&Rs"): an amendment is invalid unless the language of the original CC&Rs gave sufficient notice of the future amendment. While the new rule merely expands on existing common law, it creates new problems of defining what, precisely, constitutes sufficient notice. In doing so, the rule disrupts one of the core value propositions of the common interest community—risk mitigation by contractual reduction of uncertainty—and traps lower courts between their duty to give effect to contractual intent and their mandate to preserve and protect the Arizona Constitution. This Note examines the existing statutory and common law framework, as well as post-*Kalway *case law, to establish a four-factor test that will better define the contours of sufficient notice in a way that strikes a balance between preserving homeowners' property rights and giving community associations flexibility to address modern issues that may not have been foreseeable when their original CC&Rs were recorded.*

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INTRODUCTION

Imagine that you and I each possess a bundle of sticks. We wish to be good neighbors to each other, so we agree to resolve any disagreements by a binding majority vote, and that one bundle of sticks corresponds to one vote. To memorialize the agreement, each of us gives the other a small chunk of one of our sticks as an assurance of good faith. Later on, I find someone (let's call him Rhett) who offers to pay me in exchange for the privilege of borrowing one of my sticks. I accept Rhett's money, and he takes possession of the stick. Rhett turns around and hits you over the head with the stick. You are understandably upset that you have been hit over the head with a stick, so you sue me for breach of our prior agreement to be good neighbors to each other. Problem: nothing in our agreement prohibited me from letting Rhett borrow the stick he hit you with.

Alternatively, imagine the same arrangement as above, except now you own two bundles of sticks to my one bundle. You decide that you hate goats, and so you ban all goats within a certain radius of your home. Because you have one more bundle of sticks than I do, your unilateral decision binds me. I, the owner of many goats within a certain radius of your home, feel this is unfair because nothing in our original agreement mentioned anything about goats.

It may be evident that in both of these glib hypotheticals, the bundle of sticks is a metaphor for a piece of property.[1] Each stick in the bundle represents an individual right—to use, to exclude, to alienate, to enjoy quietly, and so on. Taken together, the bundle of sticks represents the legal property interest. Thus, property is defined not by a physical thing itself, but rather by the aggregation of rights relating to that thing.[2] But what happens when the exercise of one property owner's rights impinges on another's? In each of the above hypotheticals, the right exercised was completely valid within the four corners of the agreement, and yet the outcomes seemed unfair. Ordinarily, the preemptive resolution of such conflicts is the province of contract. If a dispute arises due to circumstances not anticipated by the parties when a contract was made, the contract may be modified by a mutually agreed amendment.[3]

In the context of common-interest communities, the contract which seeks to preemptively resolve conflicts between homeowners is the Declaration of

[1] United States v. Craft, 535 U.S. 274, 278 (2002) ("A common idiom describes property as a 'bundle of sticks'—a collection of individual rights which, in certain combinations, constitute property.").

[2] Katheleen R. Guzman, *Give or Take an Acre: Property Norms and the Indian Land Consolidation Act*, 85 IOWA L. REV. 595, 615 (2000).

[3] *See, e.g.*, RESTATEMENT (SECOND) OF PROPERTY § 89 (AM. L. INST. 1981).

Covenants, Conditions, and Restrictions ("CC&Rs"). CC&Rs are recorded to run with the title of each lot or unit within the common-interest community. Because CC&Rs are contracts involving many parties, the interests of efficiency mandate that mutual agreement be achieved not by unanimity, but by majority or plurality. This creates tension: assuming the required majority or plurality is achieved, how does the law prevent the majority or plurality from imposing a manifestly unfair result on the minority? Should it?

Arizona statutory law has answered the question of *how* to amend CC&Rs but has been silent on the issue of *when* or *why* to do so. The common law has therefore had to fill in the gaps piece by piece. The most recent piece is the March 22, 2022 Arizona Supreme Court ruling in *Kalway v. Calabria Ranch HOA, LLC*, which imposes a new rule for community associations seeking to amend their CC&Rs: an amendment is invalid unless, at the time of purchase, the language of the original CC&Rs gave sufficient notice of the future amendment. However, the standard for what constitutes sufficient notice is so broad as to create an untenable gridlock. Homeowners and homeowners' associations ("HOAs") alike are unable to adapt to or plan for changing circumstances that could not have been foreseeable when their original CC&Rs were recorded. This Note argues for a more workable test to define "sufficient notice" in a way that strikes a balance between preserving homeowners' property rights and providing community associations the flexibility to address modern issues that may not have been foreseeable when their original CC&Rs were recorded.

I. THE HOMEOWNERS' ASSOCIATION AS A MECHANISM OF GOVERNING PROPERTY RIGHTS

A homeowners' association ("HOA")[4] is an entity that, within the confines of a defined community, enforces land use regulations and provides services and amenities to an extent beyond that provided by the local public sector.[5] As of 2021, the Community Associations Institute estimated that 29% of the U.S. population resided within an HOA, encompassing roughly 74.2 million residents of 27.7

[4] This article will use the abbreviation "HOA" as a substitute for what sources may refer to as "community associations" or "Residential Community Associations." This term will encompass condominium associations, and both residential and commercial community associations.

[5] Ron Cheung & Rachel Meltzer, *Homeowners Associations and the Demand for Local Land Use Regulation*, 53 (3) J. REG'L SCI. 511, 511 (2013).

million housing units, located within 358,000 HOAs.[6] The prevalence of HOAs continues to increase—82.4% of new homes sold in 2021 were part of HOA communities (up 2.74% year-over-year).[7]

The popularity of the HOA as an enforcement mechanism arises out of two fundamental assumptions. The first assumption is that homeowners are willing and able to pay for the additional services and amenities offered by the HOA. The second assumption is that homeowners are willing to give up some control over their own properties in exchange for the value-add of similar restrictions on their neighbors, which may mitigate the risk of buying into a particular neighborhood.[8] Additionally, other sectors of the market derive benefit from the HOA structure: developers enjoy detailed statutory protections for their rights to control uniformity in the communities they build,[9] and municipalities are able to divest to developers some of the burden of providing public sector services and infrastructure development.[10] This alignment of public and private incentives is so pervasive that local governments often view HOA regulation as complementary to traditional governmental land use restrictions while developers and HOAs have become the primary lobbyists in favor of public zoning outside of their own communities.[11] Homeowners, in turn, benefit from the resulting reduction in uncertainty regarding development across the entire municipality, which serves the goal of preserving or enhancing the values of their individual properties.[12] Homeowners also gain increased collective bargaining power from their HOA, because a homeowner's voting power is proportionally larger within their HOA than it would be within their larger municipality. That voting power is further leveraged through the HOA's greater lobbying power with the municipality.[13]

Of course, this incentive structure assumes a tripartite alignment of interests between homeowner, HOA, and municipality. Where interests no longer align, the homeowner may rebel against the notion of giving up a stick in their bundle of property rights. It is this conflict which undergirds *Kalway*. As the data and market

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[6] CMTY. ASSN'S INST., 2021–2022 U.S. NATIONAL AND STATE STATISTICAL REVIEW (2022) [hereinafter CAI REPORT], https://perma.cc/C63H-6RCF.

[7] *HOA Statistics*, IPROPERTYMANAGEMENT (Oct. 9, 2022), https://perma.cc/43K9-RKBF.

[8] Cheung & Meltzer, *supra* note 5, at 511 and 515.

[9] SCOTT B. CARPENTER, COMMUNITY ASSOCIATION LAW IN ARIZONA 1 (6th ed. 2019).

[10] Cheung & Meltzer, *supra* note 5, at 513.

[11] *Id.* at 515.

[12] *Id.* at 516.

[13] *Id.*

incentives suggest, the regulatory influence of HOAs on private property rights is not likely to decline in prevalence despite the potential for conflicting interests. Indeed, HOAs outnumber formal local governmental bodies at a ratio of nearly four to one.[14] As such, case law affecting HOA regulatory powers has national significance in that it could potentially influence the property rights of a quarter of the population.

A. CC&Rs: The Mechanism of HOA Powers

Land use regulation by a municipality is a widely-accepted practice originating from a state's statutory delegation of its police powers to smaller governmental units.[15] A private quasi-government like an HOA, however, derives its power from contract principles established either through the common law or by statute. The contract that gives an HOA its power is the CC&Rs.

The developer of a community typically establishes the HOA while building the development, allocating shares of the HOA as lots or units within the development are sold to homeowners.[16] The HOA, which is often incorporated as a nonprofit corporation pursuant to a relevant state statute, establishes and enforces covenants, conditions, and restrictions governing land use. Such restrictions are typically recorded on the entire development; as such, all discrete lots or units within the development are bound by the CC&Rs.[17] CC&Rs can regulate a broad range of property uses, from the mundane (e.g., whether a homeowner can place a lawn gnome in the front yard) to the significant (e.g., whether a homeowner can expand the square footage of their house).[18] The HOA's work of enforcing the CC&Rs and managing common areas and amenities is paid for by fees called assessments, which are levied on the homeowners pursuant to the terms of the

[14] *See* CAI REPORT, *supra* note 6. As of 2022, there were 358,000 HOAs in the United States. By contrast, the U.S. Census of Governments from the same year counted 90,888 local governments, inclusive of special districts. UNITED STATES CENSUS BUREAU, *Government Units: US and State: Census Years 1942–2022*, https://perma.cc/QW7P-BAUD (last visited Sept. 11, 2023).

[15] RESTATEMENT (FOURTH) OF PROP.: LAND USE § 1.1 (AM. L. INST., Tentative Draft No. 3, 2022); *see also* Bd. of Cty. Supervisors of Prince William Cty. v. United States, 48 F.3d 520, 524 (Fed. Cir. 1995) (when local governments engage in land-use planning and control, they do so by exercising sovereign police power delegated to them by the state, typically through general enabling legislation).

[16] Cheung & Meltzer, *supra* note 5, at 513.

[17] *Id.*

[18] *Id.*

CC&Rs.[19] The preceding set of characteristics meets the definition of a common-interest community.[20] The specific statutory and common-law rules governing common-interest communities can vary from state to state, but Chapter 6 of the Restatement (Third) of Property (Servitudes) helpfully summarizes the majority rule.

A CC&R is a type of servitude, which is a legal device that creates a right or obligation that runs with the land, or with an interest in the land.[21] CC&Rs are thus contracts[22] that run with the land, which means that the rights and obligations contained therein pass automatically to successive owners or occupiers of the land.[23] As such, the law presumes that any owner who takes title to a property on which a declaration of CC&Rs is recorded does so subject to the CC&Rs. In other words, by purchasing the property, the owner consents to being bound by the terms of the CC&Rs.[24] Like any other contract,[25] CC&Rs may be modified by mutual assent of the parties. However, because CC&Rs by their very nature involve many parties (potentially tens of thousands, in the case of some communities[26]), answering the question of the degree of mutual assent needed to modify the terms of CC&Rs is a unique challenge. This challenge is the root of the problem in Kalway.

II. ARIZONA LAW ON AMENDING CC&RS

The *Kalway* case, as will be discussed below, highlights an analytical gap between statute and common law in defining the scope and subject matter of what may properly be amended in CC&Rs by majority vote. Therefore, before discussing *Kalway*, it is useful to understand the state of the law prior to the *Kalway* ruling.

[19] *Id.*

[20] RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.8 (AM. L. INST. 2000)

[21] *Id.* at § 1.1.

[22] *See, e.g.,* Ahwatukee Custom Ests. Mgmt. Ass'n, Inc. v. Turner, 2 P.3d 1276, 1279 (Ariz. 2000) ("CC&Rs constitute a contract between the subdivision's property owners as a whole and individual lot owners.").

[23] RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 1.1.

[24] *Id.*

[25] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 89 (AM. L. INST. 1981).

[26] Cheung & Meltzer, *supra* note 5, at 513.

A. Statutes

Arizona HOAs are primarily governed by two statutes—the Arizona Condominium Act of 1986 (Ariz. Rev. Stat. Section 33-1201 *et seq.*, hereinafter "Condo Act") and the Arizona Planned Community Statutes (Ariz. Rev. Stat. Section 33-1801 *et seq.*). These statutes were adopted in reaction to increased high-density development in Arizona. In the 1950s and 1960s, developers seeking to maximize the capitalization of land began utilizing the condominium form of development, which gave rise to Arizona's first HOA statute—the Horizontal Property Regime Act of 1962.[27] The Horizontal Property Regime Act was replaced by the Arizona Condominium Act in 1986, which controls today.[28] Then, in the 1970s and 1980s, developers seeking to avoid the limitations imposed by the comprehensive regulatory regime of the Condo Act began building "planned communities" of lower-density single-family residences.[29] In response, the Arizona legislature enacted the Planned Community Statutes in 1994.[30] Prior to June 24, 2014, municipalities and counties could require developers to establish HOAs for newly-built communities.[31] Subsequent modifications thereto[32] limited conditions for which such requirements could be imposed, but did not change the popularity of HOAs among developers establishing new communities.

The Condo Act sets a statutory minimum for the majority necessary to amend CC&Rs: 67% of eligible unit owners in the HOA.[33] The CC&Rs may require a larger majority, but not a smaller one.[34] By contrast, the Planned Community Statutes do not impose a statutory majority requirement, instead providing that CC&Rs can be amended by affirmative vote or written consent of the number of owners specified in the CC&Rs.[35] While the mathematical concept of a majority, and the CC&R's definition of the required majority necessary to approve an amendment, are not controversial, the question of *what* may properly be amended by a majority vote has been the subject of much debate in case law.

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[27] CARPENTER, *supra* note 9, at 1.

[28] *Id.*

[29] *Id.* at 109.

[30] *Id.*

[31] ARIZ. REV. STAT. ANN. § 9-461.15 (2014) and ARIZ. REV. STAT. ANN. § 11-810 (2014).

[32] S.B. 1482, 51st Leg., 2nd Reg. Sess. (Ariz. 2014).

[33] ARIZ. REV. STAT. ANN. § 33-1227(A) (2014).

[34] *Id*.

[35] ARIZ. REV. STAT. ANN. § 33-1817(1) (2014).

B. Case Law

In the absence of statutory guidance as to the proper scope or subject of a CC&R amendment, case law has developed in an attempt to define a framework into which such amendments must fit.

Most significant to the *Kalway* case is the rule laid down in *Dreamland Villa Community Club, Inc. v. Raimey*, 226 P.3d 411 (Ariz. Ct. App. 2010)—that a CC&R amendment may not "unreasonably alter the nature of the [original] covenants, to which implicit agreement was historically given."[36] In *Dreamland*, the original CC&Rs contained only restrictive covenants pertaining to each lot owner's personal residence, and made no mention of a community association or common areas.[37] The amendment at issue sought to levy assessments on all owners in the community to support the Dreamland Villa Community Club ("DVCC"), which was a nonprofit corporation created to provide recreational facilities to its members.[38] Membership in DVCC was voluntary for homeowners who wanted the benefits of the recreational club; homeowners who opted to join were required to pay a membership fee.[39] The special assessment, therefore, was levied only on those homeowners who declined to join the DVCC.[40] In effect, the amendment imposed mandatory membership in a nonprofit corporation where there had previously been no such provision in the CC&Rs. Although the amendment had been passed by a majority vote, the question was whether a majority vote of lot owners was sufficient to require membership in DVCC and the imposition of assessments where, again, there had previously been no such provisions.[41] The Arizona Court of Appeals held that the amendment unreasonably altered the nature of the original CC&Rs to which implicit agreement was historically given.[42] The validity of an amendment by majority vote relied on the presumption that, by

[36] Dreamland Community Club, Inc. v. Raimey, 226 P.3d 411, 420, ¶ 38 (Ariz. Ct. App. 2010).

[37] *Id.* at 418, ¶ 30.

[38] *Id.* at 412, ¶ 3. *Nota bene*, this arrangement of the DVCC meets the definition of a common-interest community. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2(1)(b) (AM. L. INST. 2000) ("[A] real-estate development . . . in which individually owned lots or units are burdened by a servitude that imposes an obligation that cannot be avoided by nonuse or withdrawal . . . to pay dues or assessments to an association that provides services or facilities to the common property or to the individually owned property . . . .").

[39] *Dreamland*, 226 P.3d at 417, ¶ 23.

[40] *Id.* at 413, ¶ 5

[41] *Id.* at 418, ¶ 30.

[42] *Id.* at 420, ¶ 38.

taking title subject to the original CC&Rs, all homeowners had implicitly consented to be bound by such a majority vote.[43] An amendment that unreasonably altered the nature of the CC&Rs did not enjoy the presumption of implicit consent. The nonmember homeowners upon which the assessments were imposed could not be properly said to have consented to the amendment because the amendment was so fundamentally out of step with the character of the original CC&Rs.

Ancillary to *Dreamland* are the cases *Shamrock v. Wagon Wheel Park Homeowners' Association*[44] and *Wilson v. Playa de Serrano*.[45] Both cases involved amendments to the HOAs' bylaws rather than actual recorded amendments to CC&Rs. Both cases have essentially the same holding: a subsequent modification to a homeowner's rights (in *Shamrock*, creating an HOA where one had previously not existed under the original CC&Rs[46]; in *Wilson*, restricting occupancy to those aged fifty-five or older[47];) is not valid unless it is of a nature contemplated by, and consistent with, the original CC&Rs to which homeowners are presumed to have consented.

In summary, prior to *Kalway*, the state of Arizona case law on the proper scope and subject matter of amendments to CC&Rs was that a restriction to a homeowner's property rights, whether through recorded amendment to the CC&Rs or by adoption of or modification to an HOA's bylaws, may not unreasonably alter the nature of the original CC&Rs to which the homeowner implicitly consented by taking title subject to the CC&Rs. There remained, however, a glaring open question: what, precisely, constitutes an unreasonable alteration of the nature of the original CC&Rs? It is this question that the Arizona Supreme Court attempted to answer in *Kalway*.

[43] *Id.* at 414, ¶ 10 ("Our appellate courts have held that when a homeowner takes a deed containing [a] deed restriction that allows for amendment by the vote of a majority of homeowners, that homeowner implicitly consents to the subsequent majority vote to make membership in a homeowner association mandatory.") (citing *Shamrock v. Wagon Wheel Park Homeowners Ass'n*, 75 P.3d 132 (Ariz. Ct. App. 2003)).

[44] Shamrock v. Wagon Wheel Park Homeowners Ass'n, 75 P.3d 132 (Ariz. Ct. App. 2003).

[45] Wilson v. Playa de Serrano, 123 P.3d 1148 (Ariz. Ct. App. 2005).

[46] *Shamrock*, 75 P.3d at 134.

[47] *Wilson*, 123 P.3d at 1150.

III. KALWAY V. CALABRIA RANCH HOA, LLC

Calabria Ranch is a planned community located in Pima County, Arizona.[48] Since the subdivision's completion in 2015, owners of parcels within the community had been subject to the original recorded CC&Rs which contained a provision that the CC&Rs could be amended "at any time by an instrument executed and acknowledged by the [m]ajority vote of owners."[49] The CC&Rs also contained a general purpose statement proclaiming they were meant to "protect the value, desirability, attractiveness and natural character of the Property."[50] A "majority vote" was to be four votes out of a possible six total.[51] Kalway's lot, at approximately 23 acres, was the largest of the five lots in the subdivision.[52] The remaining four lots ranged from 3.3 to 6.6 acres.[53] Kalway's lot was allocated two votes due to its size; the remaining four lots each had one vote.[54]

In January 2018, a majority of property owners voted to amend the original CC&Rs to change some definitions, create new restrictions, and enact new enforcement measures against owners for violating the CC&Rs.[55] The new restrictions would have limited owners' ability to convey or subdivide their lots, restricted the size and number of buildings permitted on each lot, and reduced the maximum number of livestock permitted on each lot.[56] There was no meeting held for this vote, and thus Kalway had no opportunity to exercise his two votes.[57] Kalway did not learn of the amendments until roughly three months after they had been passed.[58] Upon learning of the amendments, Kalway sought a declaratory judgment in Pima County Superior Court that the amendments were invalid because they had been adopted without his consent.[59] Calabria Ranch HOA asserted that the amendments were valid because they had been enacted in the manner prescribed by the original declaration (i.e., majority vote).[60]

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[48] Kalway v. Calabria Ranch HOA, LLC, 506 P.3d 18, 22, ¶ 2 (Ariz. 2022).

[49] *Id.* ¶ 2–3.

[50] *Id.* ¶ 2.

[51] *Id.* ¶ 3.

[52] *Id.* ¶ 2.

[53] *Id.*

[54] *Id.* ¶ 3.

[55] *Id.* ¶ 4.

[56] *Id.*

[57] *Id.*

[58] *See* Kalway v. Calabria Ranch HOA, LLC, No. 2 CA-CV 2019-0106, 2020 WL 1239831, at *1, ¶¶ 2–3 (Ariz. Ct. App. Mar. 13, 2020).

[59] *Kalway*, 506 P.3d at 23, ¶ 5.

[60] *Id.* at 22, ¶¶ 1, 3.

The trial court found the amendments that "unreasonably and unforeseeably alter[ed]" the nature of the original CC&Rs to be invalid under the *Dreamland* analysis summarized above.[61] The trial court did not invalidate the amendments it found sufficiently consistent with the general purpose statement of the CC&Rs (i.e., protecting the value, desirability, attractiveness, and natural character of the properties).[62] In keeping with Arizona's general acceptance of the "blue pencil" rule,[63] the trial court severed the amendments it found invalid.[64]

Kalway appealed, arguing that all the amendments were invalid without unanimous consent.[65] The Arizona Court of Appeals affirmed the trial court's holding in a 2–1 vote on the ground that the original CC&Rs put Kalway on notice that the CC&Rs could be amended by majority vote.[66] Moreover, the court held that the general-purpose statement in the CC&Rs was sufficient to provide notice of the amendments.[67] The court noted that Kalway cited "no authority to support his argument that unanimous consent was required to amend the CC&Rs here, nor have we found any."[68] A partial dissent suggested that the majority's reliance on each amendment's harmony with the general-purpose statement would permit "a gauzy statement of purpose" to justify any new amendment, thereby rendering the *Dreamland* rule "a nullity."[69]

Kalway further appealed to the Arizona Supreme Court, which issued an opinion on March 22, 2022 overturning both the trial and appellate court's holdings.[70] The four amendments which were found invalid in whole or in part by the trial court were not challenged by Calabria Ranch HOA in the appeal process, and thus were not reviewed by the Arizona Supreme Court.

The central issue before the Arizona Supreme Court was whether general amendment powers and general purpose statements in CC&Rs, on their own, are a sufficient basis on which an HOA may pass an amendment over the objections

[61] *Kalway*, 2020 WL 1239831, at *2, ¶ 6.

[62] *Id.*

[63] *See, e.g.*, Valley Med. Specialists v. Farber, 982 P.2d 1277, 1286 (1999) ("Arizona courts will 'blue pencil' restrictive covenants, eliminating grammatically severable, unreasonable provisions.").

[64] *Kalway*, 2020 WL 1239831, at *2, ¶ 7.

[65] *Kalway*, 506 P.3d at 23, ¶ 6.

[66] *Id.*; *see also Kalway*, 2020 WL 1239831, at *3, ¶ 10.

[67] *Kalway*, 506 P.3d at 23, ¶ 6.

[68] *Kalway*, 2020 WL 1239831, at *3, ¶ 10.

[69] *Id.* at *10, ¶ 39.

[70] *Kalway*, 506 P.3d at 28, ¶ 42 (Ariz. 2022).

of minority homeowners.[71] In answering this question, the court looked first to Ariz. Rev. Stat. Section 33-1817(A)(1), which provides that a "declaration may be amended by the association . . . by an affirmative vote or written consent of the number of owners or eligible voters specified in the declaration . . . ." The court held that the statute does not displace the common law rule articulated in *Dreamland*; in other words, even an amendment passed pursuant to statutorily-authorized procedures may not unreasonably alter the character of the original declaration.[72] "The original declaration must give sufficient notice of the possibility of a future amendment; that is, amendments must be reasonable and foreseeable."[73] Relying on *Dreamland*, the Court elaborated that "even a broad grant of authority to amend an original declaration," such as that provided by a general-purpose statement, "is insufficient to allow a majority of property owners to adopt and enforce restrictions on the minority without notice."[74]

The basis for this notice requirement is an exception carved out of the contractual nature of CC&Rs. Generally, Arizona courts enforce contracts as written.[75] In special types of contracts such as CC&Rs, however, courts do not enforce "unknown terms which are beyond the range of reasonable expectation."[76] This exception is grounded in a policy of protecting a homeowner's reasonable expectations against abuse by a majority.[77] The notice requirement is thus meant to protect "a homeowner's reasonable expectations based on the declaration [of CC&Rs] in effect at the time of purchase. . . ."[78]

On the above bases, the Arizona Supreme Court held that neither a general amendment power nor a general-purpose statement provides sufficient notice to homeowners of future amendments. To be valid, an amendment must have been reasonable and foreseeable to the homeowner at the time of purchase:

The restriction itself does not have to necessarily give notice of the particular details of a future amendment; that would rarely happen. Instead, it must give notice that a restrictive or affirmative covenant exists and that the covenant can be amended to refine it, correct an error, fill in a gap, or change it in a particular way.

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[71] *Id.* at 22, ¶ 1.

[72] *Id.* at 23, ¶ 10.

[73] *Id.*

[74] *Id.* at 24, ¶ 13.

[75] *Id.* ¶ 14.

[76] *Id.* (citations, quotations omitted).

[77] *Id.* at 24, ¶ 15 ("[T]he law will not subject a minority of landowners to the unlimited and unexpected restrictions on the use of their land merely because the covenant agreement permitted a majority to make changes to existing covenants.")

[78] *Id.*

But future amendments cannot be entirely new and different in character, untethered to an original covenant. Otherwise, such an amendment would infringe on property owners' expectations of the scope of the covenants.[79]

Whether the original CC&Rs gave notice of the amendments at issue is an objective inquiry that ignores the parties' subjective intentions.[80]

Recall that *Dreamland* articulated the rule that a CC&R amendment may not "unreasonably alter the nature of the [original] covenants, to which implicit agreement was historically given."[81] The *Kalway* case is significant because it expands (or perhaps constricts, depending on the reader's perspective) the *Dreamland* test to include an objective inquiry into whether the original CC&Rs gave "sufficient notice" such that a homeowner could form a reasonable expectation that the challenged amendment might arise in the future. Together, the *Dreamland* and *Kalway* cases create a framework of case law that will make any challenged amendment subject to a fact-intensive inquiry by the courts.[82] Such inquiries are nothing new in the landscape of judicial tests, but what is lacking from the *Kalway* opinion is a usable definition of what constitutes sufficient notice. It is clear that sufficient notice would be impossible for an amendment completely untethered from the character of the original CC&Rs, but in less extreme cases the question of sufficient notice becomes harder to answer. *Kalway* also leaves open the question of whether an amendment that fails under its analysis is void *ab initio*, or whether it is merely voidable. Finally, while it is true that *Kalway* leaves open the possibility that an amendment totally new in character may be approved unanimously, such a unanimity requirement creates a holdout problem that is directly at odds with the legislative intent of the statutory majority requirements set by the Condo Act and Planned Community Statutes.[83]

As a result, while at first blush the *Kalway* rule seems like little more than an incremental clarification of the existing *Dreamland* rule, it presents, but does not address, a confusing new juxtaposition of concepts. On the one hand, it (rightfully) gives great weight to a homeowner's reasonable expectations at the time of purchase; on the other hand, it prescribes a fact-intensive inquiry to

[79] *Id.* at 25, ¶ 17 (citations, quotations omitted).

[80] *Id.* ¶ 16.

[81] Dreamland Community Club, Inc. v. Raimey, 226 P.3d 411, 420, ¶ 38 (Ariz. Ct. App. 2010).

[82] *See* Valley Med. Specialists v. Farber, 982 P.2d 1277, 1281 (1999) ("Reasonableness is a fact-intensive inquiry that depends on the totality of the circumstances); Bryceland v. Northey, 772 P.2d 36, 40 (Ariz. Ct. App. 1989) ("Each case hinges on its own particular facts.").

[83] *See* Section II(A) *supra*.

determine the contours of those reasonable expectations without providing guidance to lower courts as to what conclusions should be drawn from the facts. In doing so, the *Kalway* rule makes it difficult for homeowners, HOAs, prospective purchasers, and other stakeholders to form reasonable expectations going forward, thus disrupting one of the core value propositions noted in Section I *supra*: risk mitigation via reduction of uncertainty. *Kalway* has also created an uncomfortable separation of powers issue that, without further refinement of the "sufficient notice" test, threatens to trap lower courts between their duty to effect the intent of the legislature and to uphold the Arizona Constitution.

IV. SUBSEQUENT CASE LAW APPLYING KALWAY

Lower courts attempting to apply the *Kalway* "sufficient notice" standard have struggled with the ad hoc analysis it prescribes, often reaching unpredictable results. The two cases discussed below are but a sample of the confused litigation that has proliferated in *Kalway*'s wake.

A. Cao v. PFP Dorsey Investments, LLC

The recent Arizona Court of Appeals case *Cao v. PFP Dorsey Investments, LLC*[84] is but one example of an alarming outgrowth of the *Kalway* analysis. In January 2018, Cao purchased a unit in a condominium complex subject to a declaration of CC&Rs recorded in 2007.[85] The CC&Rs granted the condominium association ("Association") the "rights, powers and duties as are prescribed by the Condominium Act [A.R.S. § 33-1201 *et seq.*]."[86] In November 2018, PFP Dorsey Investments, LLC ("PFP Dorsey") acquired ninety of the ninety-six units in the condominium complex; the remaining units were owned by individuals.[87] Under the CC&Rs, each unit is a member of the Association, and each unit equates to one vote within the Association.[88] By virtue of its ownership of ninety of the ninety-six units in the condominium, PFP Dorsey held nearly 94% of the eligible votes in the Association.[89]

[84] Cao v. PFP Dorsey Invs., LLC, 516 P.3d 1 (Ariz. Ct. App. 2022).
[85] *Id.* at 3, ¶ 4.
[86] *Id.* at 5, ¶ 17.
[87] *Id.* at 3, ¶ 5.
[88] *Id.*
[89] *Id.* at 4, ¶ 8.

In March 2019, the Association gave notice to its members of a meeting to discuss terminating the condominium[90] pursuant to Ariz. Rev. Stat. Section 33-1228, which contained a provision allowing for common elements and units to be sold following termination.[91] While the statutorily-imposed minimum vote required to ratify a termination is 80%,[92] the CC&Rs required a 90% vote.[93] Because PFP Dorsey held 94% of the votes in the Association, it was able to ratify the termination on its own, without approval of any of the other unit owners.[94] Following the termination, the Association recorded a warranty deed transferring title of Cao's unit to PFP Dorsey.[95] Cao was understandably upset by this development, arguing on appeal that the termination process effected an unconstitutional private taking.[96]

The issue on appeal relevant to this discussion was which version of the statutory provision governing condominium termination[97] should apply to Cao and PFP Dorsey—the version that was in effect at the time of Cao's purchase of the unit, or the amended statute[98] that took effect in August 2018 (hereinafter "HB 2262").[99] Noting that HB 2262 "potentially lessened protections for individual condominium unit owners subject to a forced sale,"[100] the court held that, notwithstanding the CC&Rs' incorporation of future amendments to the Condominium Act, HB 2262 did not apply to Cao.[101] The court based its holding on the *Kalway* rule that CC&Rs "must give notice that a . . . covenant exists and that the covenant can be amended to refine it, correct an error, fill a gap, or change it in a particular way," and that future amendments "cannot be 'entirely new and different in character'" such that they would "exceed the reasonable expectations of the owners."[102] Because Cao took title subject to the statute as it existed before

[90] *Id.* at 3, ¶ 6.

[91] *See* ARIZ. REV. STAT. ANN. § 33-1228(C)–(D) (2019).

[92] *Id.* § 33-1228(A).

[93] *Cao*, 516 P.3d at 3–4, ¶ 8.

[94] *Id.* at 4, ¶ 8.

[95] *Id.*

[96] *Id.* at 4, ¶ 13.

[97] ARIZ. REV. STAT. ANN. § 33-1228 (2014) (prescribing procedures for terminating a condominium and detailed appraisal requirements for payments of fair market value to unit owners).

[98] *See* H.B. 2262, 53d Leg., 2d Reg. Sess. (2018).

[99] *Cao*, 516 P.3d at 5, ¶ 17.

[100] *Id.* at 5, ¶ 17.

[101] *Id.* at 6, ¶ 22.

[102] *Id.* at 5, ¶ 20 (citing Kalway v. Calabria Ranch HOA, LLC, 506 P.3d 18, 25 (Ariz. 2022)).

HB 2262, and because HB 2262 made "substantive" changes to the procedure for determining the moneys to which a condominium unit owner may be entitled in the termination process, the court held that the CC&Rs' language incorporating future amendments to the Condominium Act "did not provide sufficient notice of such a substantive amendment" that "substantively altered owners' property rights beyond the owners' expectations of the scope of the covenants."[103] Therefore, "[the plaintiffs] took ownership of their unit in January 2018 subject to the Declaration, which incorporated the Condominium Act. And substantive amendments to the Condominium Act cannot later be incorporated into the agreement without renewed consent. Thus, the [pre-HB 2262] version of A.R.S. § 33-1228 applies."[104]

The *Cao* case illuminates two separation of powers issues that arise out of the *Kalway* "sufficient notice" standard. First, the Arizona Court of Appeals was forced to, in practical effect, invalidate a democratically-effected act of the legislature because the *Kalway* test caused a collision between the court's duties to "find and give effect to legislative intent"[105] and to uphold the Arizona Constitution. Despite language in the Condominium Act that "any provisions in the declaration that conflict with . . . this section are void as a matter of public policy,"[106] the Court of Appeals was unable to give effect to that language because "we cannot read A.R.S. § 33-1228(K) to affect agreements already in place because 'no . . . law impairing the obligation of a contract[] shall ever be enacted.' Ariz. Const. Art. 2, § 25."[107] Second, *Kalway* "sufficient notice" requirement has put the Arizona Legislature in the awkward position of having violated Article 2, Section 25 of the Arizona Constitution as applied to condominium owners who took title subject to CC&Rs prior to the enactment of HB 2262.

B. Vista Del Corazon Homeowners Association v. Smith

In a recent Pinal County Superior Court ruling in *Vista Del Corazon Homeowners Association v. Smith*, a statute was again core to the court's analysis under *Kalway*, but this time as a means of *establishing* sufficient notice.[108] In *Vista Del Corazon*, Smith purchased a single-family residence within the Vista Del

[103] *Id.* at 6, ¶ 22 (internal quotations omitted).

[104] *Id.* at 7, ¶ 24.

[105] *Id.* at ¶ 26 (quoting Secure Ventures, LLC v. Gerlach, 466 P.3d 874, 876 (Ariz. Ct. App. 2020)).

[106] ARIZ. REV. STAT. ANN. § 33-1228(K) (2019).

[107] *Cao*, 516 P.3d at 7, ¶ 23.

[108] Vista Del Corazon Homeowners Ass'n. v. Smith, No. S1100CV202200011 (Ariz. Super. Ct. Dec. 9, 2022) (ruling on matters under advisement).

Corazon Homeowners Association (hereinafter "Association"), subject to original CC&Rs which contained no restrictions on the duration for which a homeowner could rent out their property.[109] Roughly two years after Smith's purchase, the members of the Association voted by a majority of eighty percent to approve an amendment (hereinafter, "2022 Amendment") to the CC&Rs.[110] The amendment restricted, among other things, short-term rentals of the type commonly associated with Airbnb or VRBO by prohibiting any lease with a term shorter than ninety consecutive days, and prohibiting owners from leasing or renting less than their entire property.[111] The Association sued Smith to enforce the short-term rental restriction due to numerous neighbor complaints regarding "constant and unreasonable noise emanating from the Property due to [Smith's] use of the Property as a short-term rental."[112] In response, Smith raised a *Kalway* challenge to the 2022 Amendment, arguing that it was invalid under *Kalway* because the original CC&Rs did not give sufficient notice of the possibility of a rental restriction.[113]

The Pinal County Superior Court rejected Smith's *Kalway* challenge on the basis that Ariz. Rev. Stat. Section 33-1806.01 specifically authorized amendments that establish rental time period restrictions.[114] The court found that the statute made it "self-evident" that CC&Rs could be amended to restrict rental time periods, or even to prohibit rentals altogether.[115] "As such, the 2022 Amendment is foreseeable as a matter of law and the new opinion in *Kalway* does not and cannot change that."[116] The court reasoned that the legislature, in codifying Ariz. Rev. Stat. Section 33-1806.01 into law, was aware of and rejected the common-law foreseeability requirement articulated in *Dreamland* and later clarified in *Kalway*.[117] "More specifically, the Legislature's explicit approval of amendments imposing minimum rental terms clearly demonstrates that it rejected any notion that such amendments could be characterized as unreasonable or unforeseeable under *Dreamland* or *Kalway*."[118]

[109] *Id.* at 2.
[110] *Id.* at 5.
[111] *Id.* at 6.
[112] *Id.* at 7.
[113] *Id.* at 9.
[114] *Id.* at 9–10.
[115] *Id.*
[116] *Id.*
[117] *Id.* at 11.
[118] *Id.*

The superior court's gyrations to apply *Kalway* are indicative of the vagaries of the rule. While *Dreamland*'s standard of an unreasonable alteration of the original CC&Rs would seem to lend itself to an inquiry limited to the four corners of the contract, *Kalway* seems to be having the unintended effect of forcing courts to look as far afield as the statutory landscape in effect at the time of the homeowner's purchase. In doing so, it stretches the legal fictions of constructive notice and constructive consent to such a thin thread as to be almost entirely lacking in credibility.

V. A BETTER TEST

As is clear from the cases discussed above, the *Kalway* rule in its current iteration has not achieved the clarifying effect it was meant to have on the existing *Dreamland* articulation of the common law. Where *Dreamland* demanded that CC&R amendments be reasonable, *Kalway* assigns foreseeability in the form of "sufficient notice" as a proxy for determining reasonableness. In doing so, rather than magnifying the common law's protection of homeowners' reasonable investment-backed expectations, *Kalway* is instead creating a legal landscape in which the average homebuyer is expected to be an expert in statutory interpretation and title analysis. This landscape exalts the form (foreseeability) over the substance (reasonableness) intended in *Dreamland*, and commits the syllogistic fallacy of assuming that because a foreseeable amendment is likely reasonable, an unforeseeable amendment is necessarily unreasonable. It ignores the possibility that an unforeseeable amendment may yet be objectively reasonable.

To put a finer point on the issue: *Kalway*'s functional prohibition on amendments that are "entirely new and different in character, untethered to an original covenant" ignores the possibility that parties to a contract might reasonably determine that their needs have changed. Just as the people may amend the constitutions of the United States and any of the fifty states pursuant to amendment processes designed to balance majority and minority interests (even in a manner that fundamentally changes the character of the original document), the current homeowners in an HOA should be able to amend a declaration of CC&Rs to reflect their interests, which may be very different from those of the homeowners in privity at the time of the original declaration. A document which governs a fundamental right must be amendable to incorporate the will of the people currently subject to it, so long as the amendment procedure is formulated to provide due process to those parties who disagree with the amendment. As courts have consistently noted, an *ex post* determination by a court is a poor

substitute for *ex ante* negotiation among parties who are better-situated to understand their own desires.[119]

These criticisms of the *Kalway* rule are a desperate cry for a legislative pronouncement of public policy regarding amendments to CC&Rs, but proposing legislation is beyond the scope of this Note. This Note instead proposes a four-factor test to be applied once a court finds insufficient notice under the *Kalway* analysis. The test is formulated to shift the focus back to the objective reasonableness standard articulated in *Dreamland*. If an amendment fails the *Kalway* analysis but passes this test, it should be found valid. The factors are nonexclusive and equally weighted, and no one factor is dispositive.

A. Factor 1: Numerical Majority

The first factor is whether the votes cast in favor of the amendment represented an actual, numerical majority of individuals in the community, or whether a single controlling interest achieved majority on its own by virtue of its ownership percentage. The former weighs in favor of the amendment's validity; the latter weighs against. This factor is designed to account for situations in which a single party wielding unequal voting power imposes its will upon a numerically-superior, but contractually-inferior, minority. While an amendment would not be automatically invalid if ratified under such circumstances, it would be subject to increased scrutiny because the circumstances would suggest that the reasonable expectations of the parties were not protected.

B. Factor 2: Voter Turnout

In the second factor, the court examines how many votes were actually cast in favor of the amendment. If the number of votes represents a token majority among a sea of abstentions, the amendment should be subject to increased scrutiny. This factor addresses the reality that, notwithstanding quorum requirements, an amendment approved by a token majority among a sea of abstentions would be more likely to subvert the reasonable expectations of the parties in a manner that could not have been sufficiently foreseeable.

[119] *See, e.g.*, Balon v. Hotel & Rest. Supplies, Inc., 445 P.2d 833, 836 (Ariz. 1968) ("A fictitious inference of law created to fill gaps in written contracts should not be held paramount over the express manifestations of intent of the parties.")

C. Factor 3: Extrinsic Statutory Provisions

The third factor is whether a statutory provision extrinsic to the original CC&Rs evidences legislative support of the subject matter of the amendment at issue. Legislative support weighs in favor of the amendment's validity. Under this factor, the statute is not a talisman to be applied for the sole purpose of establishing sufficient notice. Instead, the statute is extrinsic evidence used to determine whether the amendment comports with public policy, thus enabling a court to balance the parties' interests with any relevant public policy considerations.[120]

D. Factor 4: A Reasonable Interference

The fourth factor is whether the amendment contemplates a reasonable interference with the rights and obligations of the original CC&Rs. This analysis borrows the three-part test for when a state may modify a contractual relationship, first articulated by the United States Supreme Court in *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934), and subsequently adopted in Arizona by the Arizona Court of Appeals in *Fund Manager v. City of Phoenix Police Department Public Safety Personnel Retirement System Board*, 728 P.2d 1237 (Ariz. Ct. App. 1986). The test is as follows:

1. Has the state law operated as a substantial impairment of a contractual relationship?
2. If so, is there a significant and legitimate public purpose behind the legislation?
3. If a legitimate public purpose has been identified, is the adjustment of the rights and responsibilities of the contracting parties based upon reasonable conditions and of a character appropriate to the public purpose justifying the adoption of the legislation?[121]

Factors 3 and 4 are particularly important in light of the case law emerging in *Kalway*'s wake, in which courts are treating the statutory landscape on the date of the CC&Rs' recordation as dispositive of the sufficient notice analysis.[122]

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[120] *See* Zambrano v. M&RC II LLC, 517 P.3d 1168, 1173–74 (Ariz. 2022).

[121] Fund Manager, Pub. Safety Pers. Ret. Sys. v. City of Phoenix Police Dep't Pub. Safety Pers. Ret. Sys. Bd., 728 P.2d 1237, 1241 (Ariz. Ct. App. 1986).

[122] Recall that *Cao*, discussed in Section IV(A) *supra*, held that (1) the CC&Rs' incorporation of the statutory landscape did not give the homeowner sufficient notice of a subsequent legislative amendment, and (2) the court could not apply the amended statute because it ran afoul of the Arizona Constitution's prohibition of laws impairing contractual obligations.

Absent express recognition of this public-policy exception to Ariz. Const. Art. 2, § 25's prohibition on impairing contractual obligations, the logic that the historical statutory landscape could be dispositive of the sufficient notice analysis would open the door to unconscionable interpretations. So far, the consequences of this logic have been primarily economic—a homeowner is entitled to a little more money, or can no longer use a property as an Airbnb—and that is exactly where the consequences should stay. But what if a challenged amendment dealt with restrictive covenants discriminating against protected classes? Would a race-based restriction recorded in 1967 survive because a homeowner did not have sufficient notice of the Fair Housing Act of 1968?[123] Would a sex-based restriction recorded in 1973 survive because a homeowner did not have sufficient notice of the Housing and Community Development Act of 1974?[124] Would a restriction prohibiting disabled persons or families with children, recorded in 1987, survive because a homeowner did not have sufficient notice of the Fair Housing Amendments Act of 1988?[125] It would be absurd to say that an amendment removing such restrictive covenants is invalid on the basis of insufficient notice, or that the aforementioned legislation impermissibly impaired contractual obligations.[126] Express recognition of the legislature's ability to modify a contractual relationship, coupled with a circumspect review of the *current* statutory landscape, would prevent such absurdity.

CONCLUSION

Where the *Kalway* rule focuses primarily on the contractual intent of the parties to the original CC&Rs, this Note's proposed four-factor test shifts focus to the intent of the parties to the amendment. The four-factor test remains fact-intensive and still requires investigation of the statutory landscape, but addresses

[123] Fair Housing Act of 1968, Pub. L. No. 90-284, § 804, 82 Stat. 73, 83 (1968).

[124] Housing and Community Development Act of 1974, Pub. L. No. 93-383, § 109, 88 Stat. 633, 649 (1974).

[125] Fair Housing Amendments Act of 1988, Pub. L. No. 100-430, 102 Stat. 1619 (1988).

[126] To be fair, the *Cao* court signaled its recognition of this "reasonable interference" exception in a citation. *See* Cao v. PFP Dorsey Invs., LLC, 516 P.3d 1, 7, ¶ 23 (Ariz. Ct. App. 2022) (citing Phelps Dodge Corp. v. Ariz. Elec. Power Co-op., Inc., 83 P.3d 573, 597 (Ariz. Ct. App. 2004) for the proposition that "[a]lthough the language in the contract clauses of the federal and state constitutions is seemingly absolute, the State can impair contract obligations in the exercise of its inherent police power to safeguard vital public interests."). This factor makes the "reasonable interference" analysis explicit.

Kalway's shortcomings by directing courts' attention to the adequacy of the procedure by which the amendment was adopted, and by correcting the role of statutory law in the sufficient notice analysis. The procedural protections in the first two factors aim to preserve the property rights of the minority interests who lost the vote. Once the procedural concerns are satisfied, the third and fourth factors ensure that the amendment at issue would not offend public policy.

Taken together, this test aims to give courts the tools they need to avoid the constitutional and policy pitfalls by which they have thus far been distracted. Armed with these tools, courts can better strike a balance between giving the majority the flexibility it needs to address modern challenges, and ensuring adequate procedural protections for the minority burdened by that flexibility. In doing so, courts applying this test in conjunction with *Kalway* will be able to facilitate, rather than impede, the alignment of interests between homeowner, HOA, and government that is so crucial to the market-driven success of the HOA as a mechanism for beneficial economic development.