



1 condominium unit owners to its terms. A copy of the CC&Rs is agreed to be admitted as  
2 Respondent's Exhibit C.

3 5. The CC&Rs legally described a parcel of property located at 2302 N.  
4 Central Avenue, Phoenix, Arizona 85004, bounded to the north by Vernon Avenue, to the  
5 south by Encanto Boulevard, to the east by Central Avenue, and to the west by First  
6 Avenue (the "Property").

7 6. The Association is the community association for the Property.

8 7. TOC has owned and continues to own its units.

9 8. In 2008, the TOC's representative Joanne Carras became a member of  
10 the Association's board. During her tenure on the board, Ms. Carras stored the  
11 Association's records at her residence. Following a homeowner petition in January  
12 2011 seeking her removal, Ms. Carras resigned from the board. Ms. Carras did not return  
13 the Association's records, but instead, absconded with those files when she relocated to  
14 California.

## 15 **II. LITIGATION**

16 9. On January 23, 2014, TOC filed an action (Maricopa County, Arizona  
17 Superior Court case no. CV2014-090103) ("TOC Litigation") against the Association and  
18 others seeking recovery for, among other things, breach of the CC&Rs and breach of the  
19 implied covenant of good faith and fair dealing.

20 10. On February 11, 2014, Matthew Hodeaux commenced an action (Maricopa  
21 County, Arizona Superior Court case no. CV2014-04795) against the Association, which  
22 was later consolidated with a separate interpleader action (Maricopa County, Arizona  
23 Superior Court case no. CV2014-010230) filed by StarPointe, to deal with disposition of  
24 the Defects Settlement Funds and a claim Hodeaux was making against them ("Hodeaux  
25 Action").

26 11. On March 17, 2014, Cynthia Futter sued the Association in the Los Angeles  
27 County, California Superior Court (case no. SC122244) ("Futter Litigation"). The  
28 Association counterclaimed.

29 12. On December 18, 2014, TOC's principal, Yair Ben Moshe, filed an action  
30 against James Ehinger, in the Los Angeles County, California Superior Court (case no.

1 BC 567181) (“YBM Personal Action”).

2 13. Pursuant to Section 9 of the Association’s Articles of Incorporation (Exhibit  
3 A) and Article 1.8 of the Association’s Bylaws (Exhibit B), the Association agreed to  
4 indemnify its Directors. The Association paid for the defense of Mr. Ehinger in the YBM  
5 Personal Action. The Association recovered a judgment for attorneys’ fees upon  
6 dismissal of the YBM Action and upon affirming the dismissal on appeal to the  
7 California Court of Appeals.

8 14. On December 15, 2016, the Association commenced an action (Maricopa  
9 County, Arizona Superior Court case no. CV2016-108149) (“Foreign Judgment Action”) to  
10 collect on the California judgment.

11 15. On December 15, 2015, the Association commenced an action (Maricopa  
12 County, Arizona Superior Court case no. CV2015-096417) (“Coverage Case I”) against  
13 Liberty Mutual Underwriters Inc. (“Liberty Mutual”) claiming that Liberty Mutual  
14 incorrectly denied insurance coverage to the Association in the TOC Litigation.

15 16. On October 3, 2017, the Association commenced a second action  
16 (Maricopa County, Arizona Superior Court case no. CV2017-012686) (“Coverage Case  
17 II”) against Liberty Mutual, claiming that coverage should have been afforded in the  
18 Futter Litigation. That case remains pending.

19 17. Of the foregoing litigation, the only litigation that the Association instituted  
20 was Coverage Case I, the Foreign Judgment Action, and Coverage Case II.

21 18. The Association brought Coverage Case I and Coverage Case II to obtain  
22 coverage under its insurance policies for the TOC Litigation and the Futter Litigation.

23 **III. RETENTION OF THE DOCUMENT CONTROL GROUP**

24 19. James Ehinger is a member of the board of directors for the Association.

25 20. James Ehinger is an attorney and shareholder at Ryley, Carlock &  
26 Applewhite, P.C. (“Ryley Carlock”).

27 21. In order to defend the claims being made by Mr. Hodeaux and TOC, and to  
28 comply with its discovery obligations in that litigation, the Association conducted a  
29 search of electronically stored information (“ESI”) that had been retained by individual  
30 board members in order to reconstruct the records that were allegedly taken by Ms.

1 Carras. It was initially thought that the search would involve some 15,000 records.

2 22. On October 23, 2014, the Document Control Group (“DCG”), which is  
3 associated with Ryley Carlock, submitted a bid to conduct the review. A copy of that bid  
4 is agreed to be admitted as Respondent’s Exhibit E.

5 23. On November 20, 2014, the Association’s board met in executive session to  
6 consider hiring an ESI vendor.

7 **Facts Found in the Record**

8 24. During 2014 through 2016, the Association moved money from its reserve  
9 accounts to its operating accounts to cover expenditures not in its annual budget. Howard  
10 Kunkle, Community Manger of the Association, testified credibly that these expenditures  
11 involved both projects to improve the condominium complex as well as litigation  
12 expenses.

13 25. For 11 out of 12 months in 2016, the Association did not move money to  
14 reserves as anticipated by the reserve study it had done to ensure the financial well-being  
15 of the Association. A reserve study is a goal, not a requirement set by either CC&Rs or  
16 statute.

17 26. When the most recent reserve study was done in 2013, the Association  
18 knew it would be receiving approximately \$390,000.00 in net settlement proceeds from  
19 Liberty Mutual as a result of Coverage Case I. The settlement proceeds were received  
20 and deposited in the Association’s reserve account.

21 27. At no time during 2014 through 2016 did the Association exercise its  
22 authority under Section 7.0 of the CC&Rs to amend its budget to reflect these  
23 expenditures.

24 28. During the same time period, the Association did not consider assessing or  
25 assess a special assessment on the unit owners to cover these expenditures.

26 29. The Association viewed its budgets as a “best guess” and then would utilize  
27 reserves when needed for unanticipated or unforeseen expenses.

28 30. Mr. Ehinger became a member of the Association’s board in January 2013.  
29 Before that time, he was on the Association’s Legal Committee. As a result of both roles,  
30 Mr. Ehinger has knowledge about the litigation the Association has been involved in and  
its CC&Rs.

1           31. Mr. Ehinger testified that in his view the litigation commencement  
2 restrictions found in the CC&Rs were meant only to apply to actions involving construction  
3 defects brought against the developer, referred to in the CC&Rs as the Declarant. Mr.  
4 Ehinger noted that the litigation commencement restriction is not an independent  
5 provision but is under a section of the CC&Rs entitled "Construction Claims Procedures."  
6 He acknowledged that a Superior Court Judge dismissed without prejudice an action  
7 brought by the Association for failure to comply with the litigation commencement  
8 requirements of Section 11.3, but said that the lawyer litigating that matter had stipulated  
9 that Section 11.3 applied to the action and had chosen to make different arguments. Mr.  
10 Ehinger noted that the Association did not pursue the matter, because the order in  
11 question was not a final order and the defendant in the case later sued the Association,  
12 mooting the issue.

13           32. Mr. Ehinger indicated that the Association had attempted to amend the  
14 CC&Rs to remove Section 11.3 because it is no longer applicable, but had not been able  
15 to do so because it cannot even get 75 percent of the unit owners to vote on an issue,  
16 much less agree on a particular issue. He acknowledged that the Association did not  
17 obtain approval from 75 percent of the unit owners before filing either Coverage Case I or  
18 the Foreign Judgment Action.

19           33. Regarding Coverage Case I and the Foreign Judgment Action, Mr. Ehinger  
20 testified that these actions were defensive in nature. In Coverage Case I, Mr. Ehinger  
21 noted that the Association commenced the action against Liberty Mutual to secure a  
22 defense in the TOC Litigation. He indicated that the Association reached a settlement of  
23 Coverage Case I and placed the settlement proceeds in its reserve account. Mr. Ehinger  
24 further testified that the Foreign Judgment Action was not new, but needed to be  
25 commenced in Arizona so the Association could receive the proceeds of the judgement  
26 Mr. Ehinger received against Yair Ben Moshe, one of Petitioner's members, after it  
27 indemnified Mr. Ehinger in his successful defense against the YBM Personal Action.

28           34. Mr. Ehinger clarified that in October 2014 when the Association considered  
29 retaining DCG, which is owned by Ryley Carlock, to perform the document review the  
30 Association required, he was not a shareholder of Ryley Carlock and did not share in its  
profits.



1 3) Whether the Association violated litigation commencement requirements  
2 under is CC&Rs in the Futter Litigation and the Foreign Judgment Action in  
3 California; and

4 4) Whether the Association engaged in a conflict of interest transaction.

5 At the further hearing, Petitioner clarified that it was no longer claiming that the  
6 Futter Litigation violated the litigation commencement requirements of the CC&Rs.  
7 Instead, at hearing Petitioner focused on whether Coverage Case I and the Foreign  
8 Judgment Action violated these requirements.

9 The Administrative Law Judge previously granted partial summary judgment in  
10 this matter and agreed with Respondent that the tribunal lacked statutory authority to  
11 grant any remedy other than finding a violation of the CC&Rs or statute and, if appropriate,  
12 based on the facts, assessing a civil penalty against the Association.

### 13 CONCLUSIONS OF LAW

14 1. Petitioner filed the petition against Respondent with the Department  
15 pursuant to A.R.S. § 32-2199 *et seq.*

16 2. The Department referred this matter to the Office of Administrative Hearings  
17 for hearing and the issuance of an Order, pursuant to A.R.S. §§ 32-2199.01(D) and 32-  
18 2199.02.

19 3. Pursuant to A.A.C. R2-19-119(B), Petitioner has the burden of proof in this  
20 matter. The standard of proof is preponderance of the evidence. A.A.C. R2-19-119(A).

21 4. The CC&Rs give the Association various powers. See Article 6.0. Among  
22 these powers are the Implied Powers detailed in Section 6.5 as follows:

23 The Association may exercise any right or privilege given to the Association  
24 expressly by the Condominium Documents and every other right or privilege  
25 reasonably to be implied from the existence of any right or privilege given to  
26 the Association by the Condominium Documents or reasonably necessary  
to effectuate any such right or privilege.

27 5. Section 7.0(A) calls for the preparation of a budget and expressly states that  
28 the budget should contain “an *estimate* that the Board of Directors believes will be  
29 required” for various expenses. (Emphasis added). Within 30 days of the adoption of that  
30 budget, the Board shall sent to each unit owner a summary of the budget along with a

1 statement of the amount of the unit owner's assessment. See § 7.0(B). Section 7.0(C)  
2 provides that "[t]he Board of Directors is expressly authorized to adopt and amend  
3 budgets for the Association, and no ratification of any budgets by the Unit Owners shall be  
4 required."

5 6. After review of all the evidence and the plain language of the CC&Rs, the  
6 Administrative Law Judge finds that Petitioner has failed to prove that the Board  
7 budgeting practices violated Article 7 of the CC&Rs. The CC&Rs do not require that the  
8 Board amend its budget every time its estimated budget is incorrect. Rather Section, 7.3  
9 gives the board the authority to do so if it deems such action appropriate or if it needs to  
10 provide for additional assessments on unit owners. The Administrative Law Judge also  
11 finds that it did not violate the budgeting provisions of the CC&Rs for the Board to utilize  
12 reserve funds to cover certain expenditures as the Board had discretion to do so without  
13 needing ratification from the unit owners.

14 7. Article 11 of the CC&Rs is entitled "Construction Claims Procedures." The  
15 first subsection of that article deals with the Declarant or developer's right to cure any  
16 alleged defects. The second subsection of that article is Section 11.2, which provides in  
17 full that:

18 All legal actions initiated by Claimants (*as defined in Section 11.1 above*)  
19 shall be brought in accordance with and subject to Sections 11.3 and 11.4  
20 below. In the event a Claimant initiates any legal action, cause of action,  
21 proceeding, reference or arbitration against Declarant alleging damages for:  
22 (i) an Alleged Defect, (ii) the diminution in value of any real or personal  
23 property resulting from such Alleged Defect, or (iii) any consequential  
24 damages resulting from such Alleged Defect, any judgment or award in  
25 connection therewith shall first be used to correct and/or repair such Alleged  
26 Defect or to reimburse the Claimant for any costs actually incurred by such  
27 Claimant in correcting and/or repairing the Alleged Defect. In the event the  
28 Claimant is the Association, the Association must provide written notice to  
29 all Members prior to initiation of any legal action, cause of action,  
30 proceeding, or arbitration against Declarant which notice shall (at a  
minimum) include (i) a description of the Alleged Defect, (ii) a description of  
the attempts of Declarant to correct such Alleged Defect and the  
opportunities provided to Declarant to correct such Alleged Defect, (iii)  
certification from an engineer licensed in the State of Arizona that such  
Alleged Defect exists along with a description of the scope of work  
necessary to cure such Alleged Defect and a resume of such engineer, (iv)  
the estimated cost to repair such Alleged Defect, (v) the name and

1 professional background of the attorney retained by the Association to  
2 pursue the claim against Declarant and a description of the relationship  
3 between such attorney and the member(s) of the Board, (vi) a description of  
4 the fee arrangement between such attorney and the Association, (vii) the  
5 estimated attorneys' fees and expert fees and costs necessary to pursue  
6 the claim against Declarant and the source of the funds which will be used to  
7 pay such fees and expenses, (viii) the estimated time necessary to conclude  
8 the action against Declarant, and (ix) an affirmative statement from the  
9 Board that the action is in the best interests of the Association and its  
10 Members. In the event the Association recovers any funds from Declarant  
11 (or any other Person) to repair an Alleged Defect, any excess funds  
12 remaining after repair of such Alleged Defect shall be paid into the  
13 Association's reserve fund,

14 8. Section 11.3 follows immediately after Section 11.2 and states as follows:

15 **Approval of Litigation.** The Board shall not be authorized to incur legal  
16 expenses, including without limitation, attorneys' fees or bring any legal  
17 proceeding of a material nature for which the claimed or alleged damages or  
18 the current economic value of other available remedies would exceed  
19 \$25,000 in the aggregate, unless the Association has received the consent  
20 of not less than seventy-five percent (75%) of the votes allocated in the  
21 Membership (other than votes allocated to Declarant) to commence such an  
22 action or to incur such expenses. The foregoing restriction shall not apply to:  
23 (i) actions to enforce the collection of Assessments or an Assessment Lien;  
24 (ii) actions to challenge ad valorem taxation or condemnation proceedings;  
25 (iii) actions to defend claims filed against the Association or to assert  
26 mandatory counterclaims therein; (iv) actions to enforce any specific  
27 covenant hereunder; or (v) or claims brought by an Owner in his individual  
28 capacity concerning his Unit and Improvements located solely within his  
29 Unit; provided, further that each Unit Owner shall be bound by the  
30 mandatory arbitration provisions set forth herein and in any contract of  
purchase. In the event of any conflict between the arbitration provisions of  
this Article 11 and the contract of purchase, the contract of purchase shall  
provide. Otherwise, all provisions of this Article 11 shall be binding upon the  
Unit Owner. The Association must finance any legal proceeding with monies  
that are specifically collected for same and may not borrow money or use  
reserve funds or other monies that are collected for specific Association  
obligations other than legal fees. In the event that the Association  
commences any legal proceedings, all Owners must notify prospective  
purchasers of such legal proceedings and must provide such prospective  
purchasers with a copy of the notice received from the Declarant in  
accordance with Section 11.1 above.

9. Petitioner suggests that the provisions of Section 11.3 were violated when  
the Association filed Coverage Case I and the Foreign Judgment Action because the

1 Board did not obtain the necessary litigation approval or make assessments to the unit  
2 owners for the cost of these actions. This argument fails for two independent reasons.  
3 First, the placement of Approval of Litigation section as a subsection of the CC&Rs within  
4 the "Construction Claims Procedures" article suggests that the need for approval only  
5 applies to actions involving construction defects brought against the Declarant. It would  
6 make no sense to provide the Notice required by Section 11.1 when those actions do not  
7 involve any allegation of a construction defect and the Declarant is not a party the actions.

8 10. Second, even if the Approval of Litigation provision could be read to apply  
9 more broadly, both Coverage Case I and the Foreign Judgment Action fall within the third  
10 exception to the litigation approval restriction, namely, these actions are defensive in  
11 nature. In each case, another party's action led to the need for the Association to defend  
12 its interests. In Coverage Case I, Liberty Mutual denied coverage and the institution of  
13 Coverage Case I was an extension of the Association's attempt to defend itself in the TOC  
14 litigation. To prevent the Association from filing an action to secure a defense from its  
15 insurance company would serve no one's interest and would lead to an absurd result.

16 11. The same conclusion is warranted in the Foreign Judgment Action, which  
17 was necessitated only because a member of Petitioner, Mr. Ben Moshe, sued Mr. Ehinger  
18 who in turn sought indemnification from the Association and assigned to it the judgment  
19 he received in his favor. To prevent the Association from being reimbursed for its  
20 indemnification would not promote the fiscal responsibility Petitioner claims to expect from  
21 the Board. To the contrary, it would serve to prevent Mr. Ben Moshe from having to satisfy  
22 a duly entered judgment of the California court.

23 12. For both these reasons, the Association has not violated the provisions of  
24 section 11.3.

25 13. A.R.S. § 33-1811 provides that:

26 If any contract, decision or other action for compensation taken by or on  
27 behalf of the board of directors would benefit any member of the board of  
28 directors or any person who is a parent, grandparent, spouse, child or  
29 sibling of a member of the board of directors or a parent or spouse of any of  
30 those persons, that member of the board of directors shall declare a conflict  
of interest for that issue. The member shall declare the conflict in an open  
meeting of the board before the board discusses or takes action on that

1 issue and that member may then vote on that issue. Any contract entered  
2 into in violation of this section is void and unenforceable.

3 14. Petitioner contends that Mr. Ehinger violated the conflict of interest statute  
4 when he failed to disclose his relationship with DCG in a public meeting. This argument  
5 ignores the fact that this section is inapplicable because Mr. Ehinger did not vote on the  
6 issue; the statute addresses what a board member must do if he or she intends to cast a  
7 vote on issue presented. In any event, even if the statute applied, the evidence in the  
8 record established that Mr. Ehinger declared his relationship with Ryley Carlock in  
9 executive session and that the Board knew of the relationship between Mr. Ehinger and  
10 DCG because DCG's proposal mentioned that was the reason it was willing to the work for  
11 a flat rate. See Exhibit 26 at 2. Finally, it is not clear that Mr. Ehinger even had a conflict of  
12 interest and the time the proposal by DCG was before the Board because he became a  
13 shareholder sometime in 2015 and the proposal from DCG is dated October 22, 2014.  
14 *See id.* at 1.

15 **ORDER**

16 In view of the foregoing, IT IS ORDERED that Petitioner's petition in this matter be  
17 denied. Pursuant to A.R.S. § 32-2199.02(B), this Order is binding on the parties unless a  
18 rehearing is granted pursuant to A.R.S. § 32-2199.04 based on a petition setting forth the  
19 reasons for the request for rehearing, in which case the order issued at the conclusion of  
20 the rehearing would be binding on the parties.

21 Done this day, January 10, 2018.

22 /s/ Suzanne Marwil  
23 Administrative Law Judge  
24

25  
26 Transmitted by either mail, e-mail, or facsimile January 10, 2018 to:

27 Judy Lowe, Commissioner  
28 Arizona Department of Real Estate  
29 2910 North 44th Street, Room 100  
30 Phoenix, AZ 85018  
Attn: jlowe@azre.gov

1 Mark Nickel  
2 Christina M. Vander Werf  
3 Gordon & Rees LLP  
4 111 W. Monroe Street, Suite 1600  
5 Phoenix AZ 85003

6 Ryan J. Lorenz  
7 Clark Hill PLC  
8 14850 N. Scottsdale Rd., Ste. 500  
9 Scottsdale, AZ 85254-2798

10 By: Felicia Del Sol  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30