COURT OF APPEALS, DIVISION ONE

STATE OF ARIZONA

GALLERY COMMUNITY ASSOCIATION, an Arizona non-profit corporation, Plaintiff/Appellant, v. K. HOVNANIAN AT GALLERY, LLC, et al. Defendants/Appellees,	Case No. 1 CA-CV 23-0375 Maricopa County Superior Court No. CV2020-008714

APPELLANT'S OPENING BRIEF

Craig S. Nuss – 033839
BURG | SIMPSON | ELDREDGE | HERSH | JARDINE PC
8310 South Valley Highway
Suite 270
Englewood, CO 80112
(303) 792-5595
cnuss@burgsimpson.com

Robert G. Schaffer – 017475
HOLDEN WILLITS PLC
Two North Central Avenue
Suite 2000
Phoenix, Arizona 85004
(602) 508-6210
rschaffer@holdenwillits.com

Table of Contents

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

Treatises

PRELIMINARY STATEMENT

This appeal presents an issue of apparent first impression—the right of an association of homeowners (an "HOA") to bring a construction defect claim in its own name, as the real party in interest, with respect to two kinds of property: (1) common area property the HOA itself owns and is responsible for maintaining ("common area property"), and (2) those portions of the exterior walls and roofs of multi-unit residential buildings that the HOA does not own but is also responsible for maintaining and otherwise managing ("separately owned property").

Appellant Gallery Community Association ("Gallery HOA") appeals from a ruling that it lacks the ability to bring *either* type of claim. The lower court ruled, first, that only "condominium" associations by statute have standing to enforce owners' implied warranty rights in the separately owned portions of commonly managed property in Arizona, not "planned community" associations like Gallery HOA. Second, as to the common area improvements that Gallery HOA itself owns, the court believed the HOA holds no implied warranty because these improvements do not qualify as a "home" or otherwise "habitable." Both rulings were off base.

Gallery HOA also seeks relief from an adverse fee award, which effectively punished the homeowners for having *authorized* a claim: (a) that no Arizona court (until now) has ever even questioned much less disapproved, (b) that the trial court had just (contradictorily) reasoned the HOA "ha[d] no authority to bring . . . for the

affected homeowners," and (c) that Appellees failed to move to dismiss (on pure legal grounds) until the eve of trial after the bulk of fees awarded had already been incurred—all of which was overlooked or misstated in the order. [App. 95-100]

Because the issue of HOA standing has presented courts across the country with something of a legal Gordian knot (including several related cases percolating in the Superior Court involving the same homebuilder [App. 216-248]), we take a minute at the outset to provide some relevant history and then address the role the Arizona statutes play. HOA standing to bring construction defect claims on separately owned property for the collective benefit of owner-members may be conceptually difficult to work through, but the practical necessity of allowing HOAs to maintain such suits is not hard to see—as our own statutes *expressly permitting* defect suits by planned community associations plainly recognize.

Historical Background on HOA Standing Nationally

For peculiar historical reasons, most, but not all, states that have dealt with the issue of homeowners' association standing—including standing to bring suits enforcing (and effectively foreclosing by final judgment) their member-owners' implied warranty rights—have done so, admittedly, by statute or court rule.

Model statutes for condos first came out in the early 1960s long before the "planned community" structure came into widespread use. Several model statutes were recommended by the federal housing agencies (FHA, VA) to remove any doubt

that a condo association has standing to enforce its members' rights, which was necessary to make federal mortgage insurance available to condo buyers. *See Brickyard Homeowners' Ass'n Mgmt. Comm. v. Gibbons Realty Co.*, 668 P.2d 535, 537-39 (Utah 1983). At the time, Arizona already had its own "horizontal property regime" statutes in place. Those statutes were eventually repealed and replaced with a model condo statute in 1986, which is still in effect today, A.R.S. § 33-1201 et seq.

The push to codify the standing of condo associations arose out of some misadventurous Florida intermediate court decisions in the '60s and early '70s *disallowing* HOA standing on real-party-in-interest grounds (much like the first part of Judge Cooper's ruling here). *See* RESTATEMENT (THIRD) PROPERTY: SERVITUDES § 6.11 cmt. a (2000). These courts reasoned that individual condo owners—as tenants-in-common with fractional ownership of the common property, i.e., the condo building and all property other than the units' interiors ("TIC owners")—were the *only* real parties in interest who could sue for damage to the common property. This posed a big problem for condos, as common law courts traditionally required *all* TIC owners to be joined as necessary parties in lawsuits affecting the property. That would have been not only unduly burdensome, but by permitting "hold-outs" would be inconsistent with a condo's governing principle of majority rule.

Reflecting upon its own adoption of a special standing rule for property owners' associations (mirroring a statute it had invalidated on state separation-of-

powers principles similar to our own), the Florida Supreme Court observed: "[T]he peculiar features of condominium development, ownership, and operation indicate the wisdom of providing a procedural vehicle for settlement of disputes affecting condominium unit owners concerning matters of common interest." *Avila South Condo. Ass'n, Inc. v. Kappa Corp*., 347 So. 2d 599, 607-08 (Fla. 1977).

The Gallery Community Declaration

The legal structure of a "planned community" in Arizona (A.R.S. § 33-1801) may differ from that of a "condominium" (A.R.S. § 33-1201), but the "peculiar features" remain. Various rights and responsibilities of ownership (possession, use/enjoyment, the right to exclude others, management authority and control, sale/disposal) have been separated and allocated among the HOA and its individual owners, with implications for who, as between the HOA and its owners, has the right (or even the *duty*) to bring claims on matters simultaneously affecting individual homeowners' rights as well as the owners as a whole. *See* RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 6.4 cmt. a.

For instance, under the governing declaration in this case (the "Declaration"), decisions respecting the interior living spaces of the community's 18 townhomes are left up to each owner to handle, at their own expense. Responsibility for the exterior wall systems, roofs, and staircases of the four buildings containing the 18

townhomes, the driveway and parking areas, and the pool area improvements are to be made by the HOA, funded as necessary by assessing all owners equally.

On such matters of common interest—what the Declaration calls areas "placed under" the HOA's "jurisdiction"—all decisions about HOA-owned property and even some decisions about individually owned property (the portions of the exterior walls and roofs situated on each owner's lot) have been ceded to the collective judgment of the group, acting through its democratically elected board.

Only earlier this year, California upheld such a planned community HOA's standing to bring the same kind of claims, resting its decision not on any statute, but on longstanding prudential and equitable "considerations of necessity, convenience and justice." *River's Side at Washington Square Homeowners Ass'n v. Superior Court*, 305 Cal. Rptr.3d 532, 550 (Cal. Ct. App. 2023). The Utah Supreme Court reached essentially the same conclusion in 1983, since modified by legislation. *Brickyard Homeowners' Ass'n Mgmt. Comm.*, 668 P.2d at 542.

Statutes on Condos and Planned Communities

As noted, Arizona, like these other states, has partially addressed the question of homeowners' association standing by statute but only for "condominiums," not "planned communities." *See* A.R.S. § 33-1242(A)(4) (owners' association may litigate "in its own name on behalf of itself or two or more unit owners on matters affecting the condominium"). The Superior Court felt this distinction was dispositive

of a planned community HOA's standing. It reasoned that a planned community HOA does "not purchase the homes," "holds no implied warranty," and unlike condo associations is not "statutorily authorized" to sue on behalf of its member-owners, as was allegedly the case in *Lofts at Fillmore Condo. Ass'n v. Reliance Com. Constr.*, 218 Ariz. 574, 577 (2008). [App. 88-94]

This was, in effect, a two-part conclusion: (1) that Gallery HOA is not a *real party in interest* entitled to vindicate its owner-members' implied warranty rights in their separately owned property, and (2) that the common area property conveyed to the HOA is neither a "home" nor "habitable," and thus falls outside the scope of the implied warranty of good workmanship and habitability recognized in Arizona for "new homes."[1]

[1] This latter ruling was made even assuming that having been conveyed title by quit-claim deed and (supposedly) not "pursuant to" any contract "containing" an implied warranty, was sufficient to give the HOA implied warranty rights in the common area property. The trial court did not address Appellees' "quit-claim" argument in its ruling—likely because the HOA-owned property *was* transferred to the HOA pursuant to a contract containing an implied warranty, i.e., *the owners' purchase contracts and incorporated Declaration* (the developer didn't build the common area improvements gratis, the owners paid for them in their purchase price for their townhomes). Pursuant to these contracts, the HOA took title to the improvements, and each owner received nonexclusive easement rights of use and enjoyment over the common area property. [Declaration §§ 1.8, 3.5, App. 55-57]

Arizona's Statutes Recognizing HOA Standing to File "Homeowners' Association Dwelling Actions"

Despite the lower court's ruling, HOAs, as evidenced by the many model statutes, not to mention a large and growing number of cases nationally, have long been thought well-suited to present matters of common interest to their members for judicial resolution, including defect actions. HOAs have conducted construction defect suits in Arizona for decades, and no authority exists even questioning an HOA's standing to bring such claims in this state. *E.g., Lofts at Fillmore Condo. Ass'n*, 218 Ariz. at 577, ¶ 14.

What is more, *both* types of associations are expressly made subject to the same statutory conditions on *filing* construction defect suits—precluding any mistaken argument that the legislature impliedly intended to grant standing *only* to condo HOAs and not equally deserving owners in a planned community. *See* A.R.S. § 33-2001 et seq. ("Homeowners' Association Dwelling Actions" or "HADA"); A.R.S. § 12-1361 et seq. ("Purchaser Dwelling Actions" or "PDA").

These statutes were enacted in 1999 and 2002, respectively, and were amended in 2015 to, *inter alia*, modify and clarify the statutory conditions that must be met before a "purchaser" may file a "dwelling action," A.R.S. § 12-1362(A), or a "homeowners' association" may file a "homeowners' association dwelling action," A.R.S. § 33-2002(A). *See* Laws 2015, Ch. 60, § 7; *see also* Fact Sheet, 2015 Amendments to PDA and HADA ("Statute *permits* an HOA to file a homeowners'

association dwelling action against a seller for issues related to the design, construction, condition or sale of dwellings.") (emphasis added).

The HOA's board of directors, for instance, must ensure that "all material information" is disclosed to members regarding the lawsuit, including the anticipated expenses and how it might affect "the values of the dwellings that are the subject of the action and those that are not." § 33-2002(A)(1). There must be a vote by the board authorizing the suit at a properly noticed meeting of members. § 33-2002(A)(2)-(3). And the board must disclose in writing to the members "a plan that describes the manner in which the proceeds of a homeowners' association dwelling action . . . have been or will be allocated." § 33-2002(C).[2]

Further, a "purchaser" under the PDA is not limited to the title holder but is defined as "any person or entity who files a dwelling action." § 12-1361(9). And a "homeowners' association" is defined in the HADA statute to include both a condo association, which has been expressly accorded "statutory standing," and a planned community association, which has not. § 33-2001(4). Both are expressly made "subject to" the PDA and its notice-and-repair requirements as a condition of *filing* a "dwelling action." § 33-2003(B). "Dwelling," a term of obvious significance, is

[2] In addition to these requirements, other statutes, § 33-1813 and § 33-1804(B), permit and regulate the removal and replacement of board members and set minimum election and voting standards, ensuring both majority control over the decisions to authorize suit and allocate proceeds, and protection of minority rights to influence those decisions.

defined broadly and inclusively (and substantially the same) in both statutes—covering separately owned property *and* HOA-owned property without distinction.[3]

At most these provisions suggest that, with the limited exception of condo associations, the legislature has *not* attempted to intervene one way or the other in matters traditionally left to the judiciary, i.e., *how* a claim may be presented in court and by *whom*.[4] Certainly nothing in these statutes indicates any intent to *preclude* planned community HOAs' standing, nor did the Superior Court reason otherwise.

If anything, the PDA and HADA statutes show the legislature intended to *confer* statutory standing on both condo and planned community HOAs, as that is

---

[3] Here is the definition, in both the later-enacted PDA (additions in *italics*) and the earlier HADA statute (terms deleted from PDA's definition but remaining in HADA's are in [brackets]): "'Dwelling' means a [newly constructed] single or multifamily unit designed for residential use and *common areas* [property] and improvements that are [either] owned *or maintained* by [*a*]*n* [homeowners'] association or [jointly] by [all of the] members of [*a*]*n* [homeowners'] association. *A* [D/*d*]welling includes the systems, other components and improvements that are part of a [newly constructed] single or multifamily unit at the time of construction." §§12-1261(6); 33-2001(3). "'Dwelling action' means any action involving a construction defect brought by a purchaser against a seller of a dwelling arising out of or related to the design, construction, condition or sale of the dwelling." § 12-1261(7). "Seller' means . . . [anyone] engaged in the business of designing, constructing or selling dwellings, including construction professionals." § 12-1261(10).

[4] Other related statutes show a similar deference to the courts' final say on procedural matters. *See, e.g.*, A.R.S. § 33-1362(D)-(E) (expressing "legislature's intent" that defect trials be bifurcated in the manner the "legislature determines . . . is more efficient, fair and convenient for the parties" unless "the court finds that the circumstances of the particular case at issue render bifurcation inappropriate").

the necessary implication of the statutes. If the Court so concludes—and it should—it need go no further to resolve the standing issue.

The Specific Issues

But even if the statutes are not read to affirmatively confer standing for both types of associations, that would only raise the question, what is the standing of a planned community association in the absence of a specific statute conferring standing? More specifically, does Arizona's 1986 condo statute merely clarify and codify the already-existing standing of homeowners' associations generally under common law principles, court rules, and prudential standing tests (Gallery HOA's position), or is such a statute *necessary* to create standing where it otherwise would not exist (as the trial court essentially held)?

More specifically still, and turning to the facts of this case, under a traditional, non-statutory analysis, does an HOA have standing to sue to recover money damages to repair material deficiencies in improved realty conveyed in fee simple *either* to the HOA *or* to its member-owners (to fulfill each home sales contract), acting in one of two capacities—either:

- in its own right, in its capacity as—in *substance* under the Declaration if not the *form*—a "trustee" at common law, i.e., one who either: (i) holds title to real property for the benefit of another under an express trust (the common area property), or (ii) while not holding title, has sufficient other

rights of ownership to be deemed a trustee or similar fiduciary, including a conditional right of possession, the exclusive right and obligation of management and control, and dispositional lien rights over the property (the separately owned property) (collectively, "proprietary standing"), or

- acting on behalf of the HOA's member-owners, in an otherwise representative capacity, to recover money damages that each member-owner would be entitled to recover on their own if suing individually or joined in the action (hereinafter "associational standing")?

The Restatement Rule

The answers may raise novel and arcane issues, as evidenced by the convoluted precedent on HOA standing nationally, but the majority rule is not in doubt, as evidenced by § 6.11 of the Restatement (Third) of Property: Servitudes:

> Except as limited by statute or the governing documents, the association has the power to institute, defend, or intervene in litigation or administrative proceedings in its own name, on behalf of itself, or on behalf of member property owners in a common-interest community on matters affecting the community.

Arizona has adopted and followed this Restatement in other contexts, and the Court should adopt and follow § 6.11 here. There are no statutes in Arizona purporting to limit a planned community association's standing. Nor does the Declaration in our case purport to circumscribe Gallery HOA's authority to bring suit on matters simultaneously impacting *both* the separate property interests of its member-owners

and the collective interests of all the owners—i.e., those areas within the HOA's "jurisdiction" funded by equal owner assessments according to § 8.2.3 of the Declaration. [App. 78-79].[5]

HOAs As Real Party In Interest

In short, the nature of the relationship between planned community HOAs and their members under the various Arizona sources of substantive and procedural law governing the "real party in interest" inquiry, all support the Restatement's approach of allowing an HOA to bring suit, especially where appropriate to carry out its fiduciary obligations under the governing community documents. *See United Food and Com. Workers Union Loc. 751 v. Brown Grp., Inc.*, 517 U.S. 544, 557 (1996) ("Indeed, the entire doctrine of 'representational standing,' of which the notion of 'associational standing' is only one strand, rests on the premise that in certain circumstances, particular relationships (recognized either by common-law tradition

[5] If the Declarant *had* attempted to preclude the HOA from suing for the cost to repair defects in commonly managed property, such an unconscionable restriction—effectively prohibiting the HOA from carrying out its fiduciary duties under the Declaration—would almost certainly fail under *Zambrano v. M&RC II LLC*, 254 Ariz. 53 (2022), which held that the societal benefits from the implied warranty of good workmanship are simply too important to permit it to be disclaimed and waived in new home sales contracts. *See* RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES § 6.12 cmt. a (courts have power "under principles of equity jurisdiction, to excuse compliance with requirements that significantly impede the functioning of common-interest communities and their associations.").

or by statute) are sufficient to rebut the background presumption . . . that litigants may not assert the rights of absent third parties.").

Invoking this "common-law tradition" here, in light of the rights and duties imposed on it by the Declaration, as well as the nature of its relationship with its members—essentially a statutorily recognized, self-contained class subject to statutory safeguards designed to ensure both proper authorization and adequate representation of class members—Gallery HOA has all the authority needed to bring this action as a real party without joining its owner-members or obtaining assignments of claims.

To be sure, there are prudential limitations on an HOA's standing to act for its members in litigation and to bind them to the outcome. But where, as in this case, the owners are impacted in equal measure and are aligned in their interests (they must each pay equal assessments to address problems with association-managed property anywhere within the community), all the other statutory and court-imposed conditions to suit are met, and the owners will be bound by the outcome under *res judicata*, there is no convincing reason to prevent an HOA from presenting the entire controversy to the court for resolution.

There are, on the other hand, many good reasons for permitting HOAs to conduct the suit—most importantly, ensuring that the strong public policy giving rise to the implied construction warranties is not eroded by the manner in which

residential developers structure their developments. *Zambrano*, 254 Ariz. at 61, ¶ 16 ("policy considerations gave birth to the implied warranty"); *see also id*. at ¶¶ 24-27; *Lofts at Fillmore Condo. Ass'n*, 218 Ariz. at 577 ¶¶16-17 ("whatever the commercial utility of such contractual arrangements, they should not affect the homebuyer's ability to enforce the implied warranty against the builder").

As Gallery HOA argued below: "[P]ublic policy articulated in both *Richards v. Powercraft*, 139 Ariz. 242 (1984), and *Lofts at Fillmore Condo. Ass'n v. Reliance Commerc. Constr*., 218 Ariz. 574 (2008), applies equally to homeowner associations for townhome developments as to . . . condominium developments and individual homeowners." [IR-252 at 2] That is correct, and this Court should, accordingly, reverse and remand for trial on the implied warranty claim.

STATEMENT OF THE CASE

A. Appellate Jurisdiction

This is an appeal from a final Judgment entered by the Maricopa County Superior Court on April 27, 2023. [Index of Record ("IR")-326]. Appellants timely filed their Notice of Appeal on May 26, 2023. [IR-328] The Court of Appeals has jurisdiction over this appeal pursuant to A.R.S. § 12-2101(A)(1).

B. Course of Proceedings

On July 27, 2020, Gallery HOA filed its Complaint, alleging claims for negligence, breach of implied warranty of workmanship, and breach of

contract/breach of good faith arising out of material deficiencies in the development's improvements. [IR-1] The negligence claim was voluntarily dismissed on August 25, 2020. [IR-16]. No motion to dismiss was filed.

Defendants/Appellees K. Hovnanian at Gallery, LLC and K. Hovnanian Arizona Operations LLC thereafter filed an Answer and Third-Party Complaint against numerous potentially responsible subcontractors [IR-20-21], and the subcontractors filed Answers to the Third-Party Complaint. [IR-40, 44, 47, 51, 57, 73, 85, 100]

On February 19, 2021, Defendants and Third-Party Defendants filed a motion for summary judgment. [IR-56] The Court granted Plaintiff Gallery HOA's request for Rule 56(d) relief and extended the date for Plaintiff to respond to the motion. [IR-81] Following a stipulated dismissal of certain other defendants [IR-116, 122], Defendants and Third-Party Defendants withdrew their motion for summary judgment without prejudice on March 10, 2022. [IR-117]

On September 30, 2022, the KHov Appellees filed a second motion for summary judgment regarding each of Plaintiff's causes of action, which two nonsettling subcontractors—Appellees Desert Vista, Inc. and Renco, LLC DBA Renco Roofing—belatedly joined several months after the dispositive motion deadline, to which Gallery HOA objected. [IR-203, 262, 264] Following briefing and oral argument, on February 8, 2023 the Superior Court granted summary

judgment in favor of Appellees on Gallery HOA's remaining implied warranty, breach of contract, and breach of good faith claims, and dismissed the Third-Party Complaint as moot. [IR-290, App. 88-94] The Superior Court thereafter awarded attorneys' fees to Appellees K-Hov and the two remaining subcontractors in the total amount of $358,253.72. [IR-325, App. 95-100] Final judgment was entered on April 27, 2023. [IR-326, App. 1]

C. Relevant Facts

1. The Parties

Appellee K. Hovnanian at Gallery, LLC is the declarant, developer, and vendor of the Gallery Condominium Community townhomes, and Appellee K. Hovnanian Operations LLC is the project's builder/general contractor (collectively "Appellees" or "KHov"). [IR-242] Appellees Desert Vista, Inc. and Renco, LLC DBA Renco Roofing are the only non-settling subcontractors. [IR-73, 100]

Appellant Gallery HOA was formed as a nonprofit corporation under A.R.S. § 10-3101 et seq., through the Articles of Incorporation of Gallery Community Association ("Articles"). [IR-242] The Articles state that the "Character of Affairs" of Gallery HOA is to "manage, maintain and administer the Common Area and common facilities, . . . and to administer and enforce the Declaration of Covenants, Condition, Restrictions and Easements for Gallery . . . (the "Declaration"). [IR-242]

2. The Gallery Development

The Gallery Community townhome development consists of four residential buildings situated on 18 lots, along with the common area property lying outside the lots, located at 3124 North 71st Street, Scottsdale, Arizona. [IR-242] The 18 lots and portions of the buildings situated thereon were purchased by individual homeowners. All property and improvements within the development excluding the lots (defined in the Declaration as the "Common Area") were conveyed by quit-claim deed to Gallery HOA. [App. 242]

3. The Gallery Declaration

The Gallery development is governed by a recorded Declaration of Covenants, Conditions, Restrictions, and Easements. [App. 43-87] The Declaration recites that Declarant K. Hovnanian at Gallery, LLC formed the Association "for the purpose of the efficient preservation of the values and amenities of the Property"; that the Association "shall be delegated certain powers of administering and maintaining the Common Area, enforcing this Declaration, and collecting and disbursing the Assessments created herein"; and that the Declaration establishes, among other things, "obligations with respect to the proper development, use and maintenance of the Property" for the "mutual benefit of all future Owners, or other holders of interests in any portion of the Property," and "in furtherance of a plan to

promote and protect the value, desirability and attractiveness of the Property." [App. 49]

The Declaration provides that it "shall run with all of the Property for all purposes and shall be binding upon and inure to the benefit of Declarant, the Association, all Owners, Members and their respective successors in interest." [App. 54-55]

The Declaration grants Gallery HOA certain rights and duties:

- The duty to maintain "Association Property" for the benefit of all the Owners. [Declaration § 1.8, App. 50]
- "In order to insure [sic] a uniform appearance of the Property, the Association will, from time to time, as it may determine appropriate, paint the exterior of the Dwelling Units and repair, maintain and replace the exterior walls, stucco, façade, roofs or other surfaces." [*Id*. § 8.1.7, App. 70]
- "Without the Owners' approval, the Association shall have the right, in its sole and absolute discretion, as to the Common Area conveyed, leased or transferred to it *or as to any other area placed under its jurisdiction* . . . [r]econstruct, repair, replace or refinish any improvement or portion thereof upon the Common Area *or any other*

area placed under its jurisdiction." [*Id*. §§ 8.2.3, 8.2.3.2 (emphasis added), App. 78-79]

Further, the Declaration specifically *prohibits* Gallery HOA's member-owners from repairing or altering the "exterior appearance" of their townhomes:

- "No improvement, alteration, landscaping, repair, excavation or other work which in any way alters the exterior appearance of the Property or the improvements located thereon from its natural or improved state existing on the date such Property was first conveyed by Declarant to a homebuyer shall be made without the prior approval of the [Association]." [*Id.* § 8.1.5, App. 69]

Finally, the Declaration makes all owners mandatory members of the Association, and authorizes Gallery HOA to make annual and special "assessments" against each owner-member's lot:

- "[t]o provide for the operation and management of the Association and to provide funds for the Association to pay for the improvement, maintenance and replacement of the Common Area, and to perform the Association's duties and obligations under this Declaration, the Articles and the Bylaws, including, without limitation, the establishment of reasonable reserves for replacements, maintenance and contingencies."

- Such assessments, "[e]xcept as provided herein . . . must be fixed at a uniform rate for all Lots . . ."
- Such assessments operate as a "lien" on the owner-member's lot and "shall be in favor of the Association and shall be for the benefit of all Owners except the defaulting Owner," which the Association may enforce by suit as a personal obligation of the owner, and may "foreclose[] by appropriate action in court in the manner provided by law for the foreclosure of a realty mortgage." [Declaration §§ 6.1, 6.2, 6.7.1, App. 61-63]

Despite delegating broad and exclusive authority to the Association to make decisions respecting both the common areas owned by the HOA and the common exterior aspects of the townhomes owned by the member-owners, the Declaration—unsurprisingly (since KHov drafted it)—does not *expressly* grant Gallery HOA the right to sue the developer, builder, or vendor for construction defects for the benefit of the Association or its member-owners.

4. Specific Defect Allegations

Gallery HOA filed its Complaint "pursuant to A.R.S. § 12-1361, et seq. and § 33-2001, et seq., alleging defects in construction of both common area property and separately owned property, both of which the HOA has the duty to repair and maintain. [IR-1 ¶¶ 5, 6, 32-36] Gallery HOA's obligations under the Declaration to

repair and maintain these areas was admitted. [IR-20 ¶¶ 5] The specific defect allegations, including poor workmanship and failure to follow contract specifications, were compiled in an expert report prepared for Gallery HOA to substantiate its claims. [IR-242]

ISSUES PRESENTED

1. Did the Superior Court err in holding that the implied warranty of good workmanship as recognized in Arizona is limited to "homes" or otherwise "habitable" structures (i.e., not swimming pools, cabanas, pergolas, putting greens, etc.)?

2. Did the Superior Court err in holding Plaintiff Gallery Community Association, a "planned community" homeowners' association under A.R.S. § 33-1801, cannot assert a claim for breach of the implied warranty of good workmanship to recover the cost of repairing material deficiencies in (1) the exterior walls and roofs of property owned by its members that the Association is exclusively obligated to manage for their benefit, or (2) common area property the Association itself owns and is exclusively obligated to manage for the owners' benefit.

3. Should the award of attorneys' fees and costs entered against Gallery HOA be vacated either because the trial court's ruling must be reversed or for other reasons?

ARGUMENT

I. GALLERY HOA MAY RECOVER DAMAGES FOR DEFECTS IN COMMON AREA PROPERTY THAT IS NOT A HOME OR HABITABLE.

The Court should reverse the holding that Gallery HOA is not able to sue for material deficiencies in its own common area property on the basis that the property is not a home, even though it was transferred to the HOA for the benefit of the owners as part of their home purchases, and over which the owners have appurtenant easement rights.

Simply put, this ruling should be reversed because implied construction warranty rights in Arizona have never been *restricted* to "new homes" or "habitable" structures as KHov argued below and the trial court evidently accepted. That conclusion is based on a myopic misreading of only the most recent Arizona implied warranty cases, which deal with residences and so naturally discuss only the implied warranty as applied to new home construction.

But the implied warranty of good workmanship—as recognized by our courts and the legislature (via the registrar of contractors statutes)—has never been restricted to residential construction or habitable structures. *See, e.g., Highland Vill.*

Partners, *LLC v. Bradbury & Stamm Constr. Co., Inc.*, 219 Ariz. 147 (App. 2008) (acknowledging existence of implied warranty of workmanship in construction of non-residential buildings); *Hayden Bus. Ctr. Condos. Ass'n v. Pegasus Dev. Corp*., 209 Ariz. 511 (App. 2005) (same); *Buchanan v. Scottsdale Env't Const. & Dev. Co.*, 163 Ariz. 285 (App. 1989) (implied warranty imposed on vacant land improvements because a sitebuilder should be "equally responsible for its work as a homebuilder"); *see also Zambrano*, 254 Ariz. at ¶18 ("The legislature has also recognized the importance of holding builders in general to sufficient workmanship standards by requiring the registrar of contractors to establish 'minimum standards for good and workmanlike construction.'").

Contrary to the trial court's belief, the implied warranty of workmanship equally applies to *any* new construction incorporated into realty by those holding themselves out as licensed construction contractors, including the common area improvements and amenities like the deficient staircases and pool cabana.

This was recognized in several Arizona decisions that *Columbia Western* cited and relied on in *extending* the implied construction warranty to new homes. As *Lofts at Fillmore Condo. Ass'n* explained, "*Columbia Western* turned to *settled Arizona law* holding that 'a contractor impliedly warrants that the construction he undertakes which ultimately becomes realty will be performed in a good and workmanlike manner.'" 218 Ariz. at 576, ¶ 9 (emphasis added). *Columbia Western* then held,

according to *Lofts*, "that an implied warranty of good workmanship and habitability was *also* given in connection with new home construction" and "arises from the *construction* of a new home." *Id.* (first emphasis added).

Although the "habitability" component of the implied warranty obviously applies to living quarters, to say the warranty itself, including its "fitness" and "good workmanship" components, is limited to homes is contrary to "settled Arizona law," as recognized in *Lofts*. It is also contrary to statute. *See* A.R.S. § 12-552(C) (statute of repose is applicable to actions based on implied warranties, "including implied warranties of habitability, fitness or workmanship").

When *Columbia Western* extended the implied warranty to new homes, courts already recognized a separate warranty of fitness and good workmanship for amenities and structures used other than as an abode. *See Columbia W. Corp. v. Vela*, 122 Ariz. 28, 31 (App. 1979) (citing *Cameron v. Sisson*, 74 Ariz. 226 (1952) (implied warranty imposed on well driller); *Reliable Elec. Co. v. Clinton Campbell Contractor, Inc.*, 10 Ariz.App. 371 (1969) (implied warranty applied to installation of electrical system for brick kiln); *Kubby v. Crescent Steel*, 105 Ariz. 459 (1970) (roof built over existing shed)).

The basic principle—when hiring professional construction services affecting realty, the contractor impliedly promises to deliver defect-free work. Therefore, in light of the parties' imbalance of knowledge and skill, and because the contractor is

best situated to prevent problems, the law implies a warranty holding the contractor to its implied promise. *Zambrano*, 254 Ariz. at ¶¶ 20-27.

These policies apply just the same to construction of amenities and facilities appurtenant to and purchased along with a residence. *See Briarcliffe W. Townhouse Owners Ass'n v. Wiseman Constr. Co.*, 454 N.E.2d 363, 365 (Ct. App. Ill. 1983) ("We perceive no real distinction between the buildings and common land in the application of the public policy protecting a purchaser of a new or reasonably new home from latent defects in the building or its required amenities since the purchaser in a substantial degree must rely in either case on the expertise of the building-vendor creating the defect.").

None of these cases involved construction of a home, yet all permitted recovery for deficient workmanship. So too the statutes and contractor regulations. These cases and statutes cannot be reconciled with the trial court's holding restricting the implied warranty of workmanship to new homes and excluding similarly situated appurtenant amenities.

II. GALLERY HOA IS A REAL PARTY IN INTEREST ENTITLED TO MAINTAIN THIS CONSTRUCTION DEFECT ACTION FOR THE BENEFIT OF ITS OWNER-MEMBERS.

The Court should also reverse the holding that Gallery HOA lacks standing to sue for material deficiencies in both common area property and separately owned

property the HOA is charged with maintaining and otherwise managing for the benefit of the owners as a whole.

A. The Arizona Statutes Confer HOA Standing

As already discussed, the PDA and HADA statutes expressly permit Gallery HOA to file a construction defect "dwelling action" for both types of property. A necessary implication is that the legislature has approved such suits by planned community HOAs as well as condo HOAs. That alone is sufficient to confer statutory standing on Gallery HOA, and we incorporate that argument here. [*See*, *infra*, Preliminary Statement at 14-17.]

But even if it were otherwise, Gallery HOA still has non-statutory standing as a real party in interest under the relevant legal and equitable principles.

B. Principles of Standing, Real Party in Interest, and Nonparty Preclusion.

"An action must be prosecuted in the name of the real party in interest." Ariz. R. Civ. P. 17(b). This court rule—formerly Rule 17(a)—is read in conjunction with standing. *Strawberry Water Co. v. Paulsen*, 220 Ariz. 401, 406, ¶ 8 (App. 2008); *Laughlin Land, LLC v. Lords,* No. CA-CV 14-0193, 2015 WL 4093160, at *4 (Ariz. App. July 7, 2015) ("We interpret Rule 17(a), the real party in interest rule, in conjunction with the law of standing.").

A real party in interest is "[a] person entitled under the substantive law to enforce the right sued on and who generally, but not necessarily, benefits from the action's final outcome." PARTY, BLACK'S LAW DICTIONARY (11th ed. 2019).

In Arizona, since there is no constitutional "case or controversy" requirement like in federal court, the Court is "confronted only with questions of prudential or judicial restraint." *Armory Park Neighborhood Ass'n v. Episcopal Cmty. Servs. in Ariz.* 148 Ariz. 1, 6 (1985). "The question of standing to sue requires consideration of prudential and judicial restraint to ensure that courts do not issue mere advisory opinions, that the case is not moot, and that the issues will be fully developed by true adversaries." *All. Marana v. Groseclose*, 191 Ariz. 287, 289 (App. 1997). "These considerations require at a minimum that each party possess an interest in the outcome." *Armory Park Neighborhood Ass'n*, 148 Ariz. at 6.

Meanwhile, "[t]he purpose of Rule 17(a) is to enable the defendant to avail himself of the evidence and defenses that he has against the real party in interest and to assure the finality of the results in the application of res judicata." *Cruz v. Lusk Collection Agency*, 119 Ariz. 356, 358 (App. 1978); *see also* Ariz. R. Civ. P. 17, State Bar Committee Note, 1966 Amendment to Rule 17(a)(3) ("the modern function of the rule in its negative aspect is simply to protect the defendant against a subsequent action by the party actually entitled to recover, and to insure generally that the judgment will have its proper effect as res judicata.").

In other words, under modern practice, the question of Gallery HOA's status as a "real party in interest" is essentially a function of whether it has the authority and proper incentives to litigate the case such that its members whose interests are being represented in the action will be bound by the resulting judgment. *See Sprint Commc'ns Co, L.P. v. APCC Servs., LLC*, 554 U.S. 269, 287-88 (2008) ("[F]ederal courts routinely entertain suits which will result in relief for parties that are not themselves directly bringing suit.").

"Generally speaking, one whose interests were adequately represented by another vested with the authority of representation is bound by a prior judgment, although not formally a party to the litigation." *Ellentuck v. Klien*, 570 F.2d 414, 425-26 (2d Cir. 1978) (cleaned up); *see also Taylor v. Sturgell,* 553 U.S. 880, 893-95 (2008) (describing "six established categories" in which a nonparty may be bound by a judgment); RESTATEMENT (SECOND) OF JUDGMENTS § 41(1)(d) (nonparty may be bound by a judgment obtained by a party who, *inter alia,* is "[t]he trustee of an estate or interest of which the person is a beneficiary," [i]nvested by the person with authority to represent him in an action," or an "executor, administrator, guardian, conservator or similar fiduciary manager of an interest of which the person is a beneficiary").

Arizona law recognizes the same principles of nonparty preclusion. *See, e.g., El Paso Nat. Gas Co. v. State*, 123 Ariz. 219, 222 (1979) ("[A] judgment in favor of

or against a party representing a general class operates as res judicata in favor of or against all who are thus represented.").

Accordingly, under Arizona law, Gallery HOA is a real party in interest having standing to sue for and on behalf of its member-owners in this action if: (a) it has been properly authorized by the members to bring suit for their benefit, (b) their interests are aligned, and (c) any judgment resulting from the action will be binding on both Gallery HOA and its members. Gallery HOA meets these requirements acting in either a proprietary or associational capacity.

C. Gallery HOA Has Proprietary Standing

1. Rule 17—Real Party In Interest

Rule 17(b) itself recognizes certain common-law relationships as being sufficient, in and of themselves, to give a party standing to sue for the benefit of another having a legal interest in the case—which would otherwise require the party's joinder under Rule 19 as a necessary or indispensable party. *See* Ariz. R. Civ. P. 17(b)(1)(A)-(F) (listing personal representatives, conservators and guardians, a bailee, a trustee of an express trust, a party with whom or in whose name a contract has been made for another's benefit, and a party authorized by statute).

The common theme in all of these relationships is the existence of a special representational responsibility to act in a fiduciary capacity for those on whose behalf the party sues:

> [T]he representative may be constituted as such through some transaction antedating the litigation wherein the representative is given authority to manage and safeguard interests of a beneficiary, for example in the appointment of an executor or administrator for an estate or the creation of a trust or agency relationship. In such circumstances, the authority and responsibility to represent the beneficiary in litigation is a concomitant of the representative's general managerial authority and responsibility for the matter entrusted to him.

RESTATEMENT (SECOND) OF JUDGMENTS § 41(1)(d) cmt. a. Federal courts have reasoned the rule's express listing of real parties is thus not exclusive: "[A]nyone possessing the right to enforce a particular claim is the real party in interest even if that party is not expressly identified in the rule." 6A Wright, Miller & Kane, *Federal Practice and Procedure,* § 1543.[6]

2. The HOA Functions as a Trustee.

Here, the special representational duties the Declaration imposes on Gallery HOA are indistinguishable from those of a common-law trustee. First, Gallery HOA has been conveyed title to "Common Area" property to hold in its own name and to manage for the exclusive benefit of its member-owners, creating a typical trust relationship.

[6] Arizona Rule 17(b) is substantially identical to its federal counterpart. Accordingly, the Court may look to cases interpreting the federal rule for persuasive value. *See*, *e.g.*, *Byers-Watts v. Parker*, 199 Ariz. 466, 469 (App. 2001) (stating Arizona courts are "guided by federal case law" in interpreting procedural rules patterned after the federal rules"); *Edwards v. Young*, 107 Ariz. 283, 284 (1971) ("Because Arizona has substantially adopted the Federal Rules of Civil Procedure, we give great weight to the federal interpretations of the rules.").

Second, while the individual homeowners hold record title to their own lots and the improvements thereon, Gallery HOA has been given "sole and absolute discretion," acting "[w]ithout the Owners' approval," to "[r]econstruct, repair, replace or refinish any improvement or portion thereof upon the Common Area *or any other area placed under its jurisdiction*." [Declaration §§ 8.2.3, 8.2.3.2 (emphasis added), App. 78-79]

Read as a whole and in harmony with its other provisions, and under the correct interpretive principles (discussed later), the Declaration gives Gallery HOA *exclusive* "jurisdiction" over "the exterior walls, stucco, façade, roofs or other surfaces." [*Id.* § 8.1.7, App. 70] Individual homeowners may take no action respecting such "area[s] placed under [Gallery HOA's] jurisdiction," making the owners totally reliant on the HOA to safeguard their interests in the property.[7]

a. The Law of Trusts

A trust relationship involves "a property interest held by one person (the *trustee*) at the request of another (the *settlor*) for the benefit of a third party (the *beneficiary*)." TRUST, BLACK'S LAW DICTIONARY 1513 (7th ed. 1999). While a trustee holds legal title to the trust res, the beneficiary of a trust "gains a beneficial

[7] By contrast, Gallery HOA is not suing to repair damage to the *interior* portions of the owners' residences unless that damage resulted from deficiencies in "the Common Area or any other area placed under its jurisdiction" by the Declaration. [App. 242] Existing interior claims personal to an owner would have to be pursued through intervention, assignment, or separate action. *See Brock*, 477 U.S. at 290.

interest in the trust property." *In re Naarden Tr.*, 195 Ariz. 526, 529, ¶ 11 (App. 1999); RESTATEMENT (THIRD) OF TRUSTS § 42, cmt. a (2003) ("[B]eneficiaries hold the beneficial interests (or 'equitable title') in the trust property, while the trustee (ordinarily) holds 'bare' legal title to the property.").

"The essential elements of a trust are a competent settlor and a trustee, clear and unequivocal intent to create a trust, ascertainable trust res, and sufficiently identifiable beneficiaries." *Golleher v. Horton,* 148 Ariz. 537, 543 (App. 1985). "No technical expressions are needed for the creation of an express trust." *Haines v. Goldfield Prop. Owners Ass'n*, No. 1CA-CV 04-0652, 2006 WL 1160648, at *2 (Ariz. App. May 1, 2006) (quoting *O'Brien v. Bank of Douglas,* 17 Ariz. 203, 205-06 (1915)).

"[T]he simple idea behind trusteeship . . . is that one . . . may be given a legal position with reference to a thing which may roughly be described as that of 'owner,' and at the same time be subjected to such changes or burdens with reference to his use of that thing for the benefit of another that the latter may be deemed the beneficial owner." *Lane Title & Tr. Co. v. Brannan*, 103 Ariz. 272, 277 (1968) (quoting Isaacs, *Trusteeship in Modern Business*, 42 Harv. L. Rev. 1048, 1049 (1929)).

"At law, [a trustee] is the real proprietor, and he represents himself, and sues in his own right." *Navarro Svgs. Ass'n v. Lee*, 446 U.S. 458, 463 n.10 (1980) (quoting *Bank of United States v. Deveaux*, 5 U.S. 61, 91 (1809) (Marshall, C.J.)).

b. Trustee lawsuits are binding on beneficiaries.

There is no question that under Arizona law, as elsewhere, the outcome of a suit by a trustee (or analogous fiduciary) adequately representing beneficiaries' interests is binding on those for whose benefit the action was brought. *See Taylor*, 553 U.S. at 894-95 ("Representative suits with preclusive effect on nonparties include properly conducted class actions and suits brought by trustees, guardians, and other fiduciaries."); *Only Collections, Inc. v. Cochise Co.*, 121 Ariz. 310, 312 (App. 1978) ("A judgment against the trustee in an action in which the beneficiaries need not be made parties is binding on the beneficiaries."); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 41 cmt. a ("Judgments for or against the representative are binding upon the person he represents" with some exceptions).

c. Trustees may be held liable for failing to bring suit.

Indeed, other courts upholding HOA standing to bring defect actions reason that an association's board may face liability to its members for breach of fiduciary duty in *failing* to bring a construction defect action for their benefit within the applicable statute of limitations. *See, e.g., Greenstein v. Council of Unit Owners of Avalon Court Six Condominium, Inc.*, 29 A.3d 604, 612 (Md. Ct. Spec. App. 2011)

(citing *Queen's Grant Villas Horizontal Prop. Regines I-V v. Daniel Int'l Corp.*, 335 S.E.2d 365 (S.C. 1985) ("Should the [association] not uphold its duty to pursue a recovery for any alleged construction defects in the common elements which it maintains, it may be liable to the homeowners for its omissions."); *see also Siller v. Hartz Mountain Assocs*., 461 A.2d 568, 574 (N.J. 1983) ("The association's board of directors, trustees or other governing body have a fiduciary relationship to the unit owners."); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 41 cmt. a ("the represented person may have an action against the representative for breach of his duty to conduct the representation in a faithful, diligent, and prudent way").

d. Trustees have implied authority to sue to fulfill fiduciary duties.

Arizona law is also pellucidly clear, like the Restatement (Second) of Judgments (quoted above), that a trustee, fiduciary, or agent has implied authority to carry out its duties to the beneficiaries/principals, and that includes the implied authority to file suit in its own name to protect their interests (and the fiduciary's own proprietary interests). *See Citibank (Ariz.) v. Miller & Schroeder Fin., Inc.*, 168 Ariz. 178 (App. 1990) (deciding that bank, as trustee of revenue bonds, had duty to safeguard bonds and therefore possessed sufficient interest to confer standing on it to sue for wrongful pay out of funds); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 41(1)(d) cmt. a ("the authority and responsibility to represent the beneficiary in litigation is a concomitant of the representative's general managerial

authority"); *see also id.* cmt. b ("The person or persons standing in the position of managerial authority have a correlative representational status in litigation concerning the interests for which they are responsible.").

Suits by trustees or other fiduciaries to recover damages to fulfill their duties to nonparties are not uncommon. *See Brown Grp.*, 517 U.S. at 557-58 (noting the "wide variety of other contexts in which a statute, federal rule, or accepted common-law practice permits one person to sue on behalf of another, even where damages are sought"); *Matter of Oil Spill by the Amoco Cadiz Off the Coast of France*, 954 F.2d 1279, 1319 (7th Cir. 1992) ('[R]epresentative damages litigation is common—from class actions under Fed. R. Civ. P 23(b)(3) to suits by trustees representing hundreds of creditors in bankruptcy to *parens patriae* actions by state governments to litigation by and against executors of decedents' estates.") (per curiam).

e. Summary: Gallery HOA is a trustee with litigation authority.

In this case all the important elements of a common-law trust relationship are present. Gallery HOA was designated to hold title to the common area property and was authorized to exercise sole management authority over both that property and the exterior portions of the buildings and roofs for the exclusive benefit of the owners, at their collective expense. And each of the owners was separately deeded title to essentially undivided property interests in the common area property and improvements, appurtenant to and transferrable with their lots (*i.e.*, nonexclusive

easements not materially different than the use rights of TIC owners in condo common areas).

Along with exclusive management authority and control comes the implied duty and concomitant authority to protect owners' interests in avoiding unexpected maintenance expenses because builders did not deliver what they impliedly promised—not just a home without material deficiencies, but appurtenant common facilities as well. As the Court reasoned in *Citibank (Ariz.)*, having a fiduciary duty to safeguard property necessitates "the ability to remedy situations which interfere with those duties," and "this ability, which includes the right to maintain an action . . . , arises naturally as part of the duties described." 168 Ariz. at 183.

"This court has clearly stated that with respect to real estate sales, we will not exalt form over substance." *Kadera v. Superior Court*, 187 Ariz. 557, 564 (App. 1996). "We must look to the purpose of the instruments, their substance and not their form." *E-Z Livin' Mobile Sales, Inc. v. Van Zanen*, 26 Ariz.App. 363, 364 (App. 1976).

Certainly as to the common area property, the HOA is functioning as, and therefore must have the same standing as, a trustee or like fiduciary. (The Court thus need not determine whether any individual homeowner might also have standing to bring the common-area defect claim and, if it does, whether that owner could recover the full cost to repair the common property or only its individual (1/18th) share of the

cost.) *See, e.g.*, *Stony Ridge Hill Condo. Owners Ass'n v. Auerbach*, 410 N.E.2d 782, 786 (Ct. App. Ohio) ("The Owners Association, on behalf of all unit owners and for each of them, is the proper party to bring an action for damages pertaining to the common area sustained by any or all of the unit owners. Payment by defendants of only one-sixth of the roof damage . . . would be the equivalent of giving plaintiff no legal remedy or relief whatever.") (citation omitted).

Though Gallery HOA does not hold formal title to the individual lots, each lot owner ceded to the HOA in the Declaration important rights and responsibilities of ownership over the exterior components of the buildings—namely, possession, management, and control—"without the Owners' approval" (not as a mere agent subject to each owner's control)—as well as "dispositional rights," by virtue of its ability to foreclose assessment liens. Having such rights of ownership, only to be exercised in a fiduciary capacity, also makes Gallery HOA a trustee with respect to the common aspects of the owners' separately owned property.

This conclusion is supported by *Kadera*, 187 Ariz. 557, in which this Court held that a member of a residential "cooperative," not holding any title to property but only use rights in her individual unit, was nevertheless an "owner" for purposes of a forcible-entry-and-detainer action. The court reasoned: (1) "[p]roperty does not necessarily refer to a physical object itself but to certain rights over the physical object"; (2) "ownership may be defined as 'the right to [possess], use, and [dispose]

of the thing in such a manner as is not inconsistent with law'"; (3) "[t]he word 'ownership' covers different estates in real property and . . . has no technical meaning"; and (4) "in Arizona statutes, we must interpret the word 'ownership' to have 'the widest variety of construction, usually guarded in some measure by the object sought to be accomplished." *Id.* at 563-64 (citations omitted).

Gallery HOA has been given exclusive authority to protect property belonging to others (themselves as owners). Gallery HOA's fiduciary duties, including the duty to bring this action, "'result from the trust relation, and are not based upon an agreement or contract, and are enforceable even though the trustee received no consideration." *In re Naarden Tr.*, 195 Ariz. at 529, ¶ 12. Thus, Gallery HOA must be considered, in substance, a "trustee" or "similar fiduciary," RESTATEMENT (SECOND) OF JUDGMENTS § 41(1), having a right to sue to recover damages for harm to property exclusively managed by the HOA for the benefit of its member-owners, who will be bound by the outcome—even if the HOA does not "own" that property in the sense of holding record title.

D. Gallery HOA Has Associational Standing

Arizona law is even clearer that an association like Gallery HOA has standing to sue on its members' behalf where "given all the circumstances in the case, the association has a legitimate interest in an actual controversy involving its members and . . . judicial economy and administration will be promoted by allowing

representational appearance." *Armory Park Neighborhood Ass'n*, 148 Ariz. at 6; *Home Builders Ass'n of Cent. Ariz. v. Kard*, 219 Ariz. 374, 377, ¶ 10 (App. 2008).

Factors courts consider in determining whether an association has standing to sue on behalf of its members include "whether: (a) the association's 'members would have standing to sue in their own right; (b) the interests . . . the association seeks to protect are relevant to the organization's purpose; and (c) neither the claim asserted nor the relief requested requires the participation of individual members.'" *Home Builders Ass'n*, 219 Ariz. at 377, ¶ 10 (alteration in original) (quoting *Armory Park Neighborhood Ass'n*, 148 Ariz. at 6). All three of these factors demonstrate that Gallery HOA has standing to sue on behalf of its members, and that participation of individual homeowners (or assignments of claims) is not required.

1. HOA Owner-Members Could Bring Defect Suits.

With respect to the first factor, there is no dispute that Gallery HOA's members would have standing to sue in their own right. Indeed, the Superior Court concluded the members "own the residences" and, therefore, "[t]he homes—and the implied warranty—belongs [sic] to the homeowners." [App. 91] The right of the Gallery homeowners to sue for breach of the implied warranty of good workmanship and habitability is beyond debate—even if, in equity, they would have to transfer any litigation proceeds to the HOA, the only entity with authority under the Declaration to make repairs. *See Rogers & Ford Constr. Corp. v. Carlandia Corp.*,

626 So.2d 1350, 1354 (Fla. 1993) (citing Paul S. Jacobsen, *Standing of Condominium Associations to Sue: One For All or All For One?*, 13 Hamline L. Rev. 15, 29-36 (1990)).

2. This Defect Action is Relevant to the HOA's Purpose.

As to the second factor, the interests that Gallery HOA seeks to protect in this lawsuit are unquestionably relevant to its purpose. Gallery HOA has a fiduciary responsibility over the care and maintenance of the improvements at issue, whether it technically "owns" them or not. Appellees' breaches of their implied warranty of good workmanship have resulted in material deficiencies that will cause costly maintenance and repairs for the Gallery homeowners, and this lawsuit is brought to prevent or ameliorate the harm to the Gallery homeowners that is reasonably likely to occur as a result of the defective construction.

Further, the fact that this lawsuit is central to Gallery HOA's mission and fiduciary responsibilities to owners "raises an assurance that the association's litigators will themselves have a stake in the resolution of the dispute, and thus be in a position to serve as the defendant's natural adversary." *Brown Grp.,* 517 U.S. at 555-56; *see also Armory Park Neighborhood Ass'n*, 148 Ariz. at 6 (holding that an association charged with "preserv[ing] the use and enjoyment of the neighborhood by its residents" could sue on residents' behalf to enjoin public nuisance).

3. Owner-Members Are Not Indispensable Parties.

Finally, because this lawsuit does not seek individual damages for separate property owners, the participation of individual homeowners is not required. The relief requested is universal to all Gallery homeowners, and principles of judicial economy favor allowing Gallery HOA to sue on its members' behalf. *Armory Park Neighborhood Ass'n*, 148 Ariz. at 6.

In *Warth v. Seldin*, 422 U.S. 490 (1975), the Supreme Court wrote, "so long as the nature of the claim and the relief sought does not make individual participation of each injured party indispensable to proper resolution of the cause, the association may be an appropriate representative of its members, entitled to invoke the court's jurisdiction." *Id.* at 511.

Armory Park Neighborhood Ass'n provided further controlling guidance: "Principles of judicial economy are advanced by allowing issues to be settled in a single action rather than in a multitude of individual actions because the relief sought is universal to all of its members and requires no individual quantification by the court." 148 Ariz. at 6; *see also Ariz. Ass'n of Providers for Persons with Disabilities v. State*, 223 Ariz. 6, 13, ¶¶ 18-19 (App. 2009) (holding association could sue on behalf of its members where the relief sought would not require "mini-adjudications" of damages unique to individual members); *Kard*, 219 Ariz. at 378 ("individualized proof").

No court has held that joinder of an HOA's members or a formal assignment of claims is strictly required under circumstances where, as here, an association seeks relief that is "universal to all of its members" and does not require "individual quantification," *Armory Park*, 148 Ariz. at 6, or "individualized proof," *Kard*, 219 Ariz. at 378.

Indeed, any litigation proceeds will be held by the Association and used for repairs, not distributed to owners, who would otherwise be responsible for paying the costs through equal assessments. *See Continental Townhouses E. Unit One Ass'n v. Brockbank*, 152 Ariz. 537, 540 (App. 1986) (affirming certification of class of owners who must pay assessments and "are financially damaged if assessments are used to pay for repairs of the Brockbank units"); *Lakeview Reserve Homeowners v. Maronda Homes, Inc*., 48 So.3d 902, (Ct. App. Fla. 2010) ("In reality a homeowners association represents the individual homeowners, and any cost of repairs to the defects in the common elements will be passed on to the homeowners in the form of assessments, regardless of whether that individual homeowner has damage to his her own property.").

Joinder of individual association members under these circumstances would be wasteful, inefficient, and cumbersome, and is not required. *See, e.g.*, *Int'l Ass'n of Firefighters, Loc. 1789 v. Spokane Airports*, 45 P.3d 186, 190 (Wash. 2002) ("In short, we see little sense in an ironclad rule that has the effect of denying relief to

members of an association based upon an overly technical application of the standing rules."). Particularly where, as here, the standing rule at play is no more than a mere "*background presumption* . . . that litigants may not assert the rights of absent third parties." *Brown Grp.*, 517 U. S. at 557 (emphasis added).

4. Rule 23 Class Certification Is Not Required.

Nor must Gallery HOA or a member-owner seek formal class action status under Rule 23. An association representing its own members "is analytically distinct from the class action issue." *Retired Chicago Police Ass'n v. City of Chicago*, 7 F.3d 584, 599-600 (7th Cir. 1993) (citing *Int'l Union United Auto., Aerospace, and Agric. Implement Works of Am. v. Brock*, 477 U.S. 274, 289 (1986)).

The Seventh Circuit explained, "while an organization might prove an inadequate representative in some instances to vindicate the rights of its members because of its lack of resources and experience or because it lacks appropriate authority from its membership, it will more often present a particularly efficient vehicle for litigation from both the viewpoint of the litigants and the perspective of the judicial system." *Id.* "These efficiencies . . . distinguish suits by associations on behalf of their members from class actions." *Id.*

Further, "while a class action creates an ad hoc union of injured plaintiffs whose only common link may be their common claims, a preexisting organization can often draw upon a preexisting reservoir of experience, research, and capital." *Id.*

"These resources, continued the Court, can often sharpen the presentation of issues appreciably—one of the primary concerns of the doctrine of standing." *Id.* (citing *Brock*, 477 U.S. at 289). Further, "[t]he very forces that cause individuals to band together in an association will thus provide some guarantee that the association will work to promote their interests." *Brock*, 477 U.S. at 290.

For these reasons, courts recognize that Rule 23, which is permissive, provides an alternative method—but not the only one—for enforcing the collective and individual rights and claims of HOAs and their member-owners. *See, e.g.*, *Beazer Homes Holding Corp. v. District Court*, 291 P.3d 128 (Nev. 2012) (instructing trial courts in HOA-conducted construction defect actions to be guided but not strictly bound by Rule 23 considerations); *Brickyard Homeonwers' Ass'n Mgmt. Comm.*, 668 P.2d at 542 ("Nothing would be gained by forcing a class action upon the Brickyard Condominium unit owners nor in requiring that each of them be made parties as [a representative action] offers a less burdensome alternative for legal representation.").

Where the claims relate to matters of common interest affecting the association members in a similar way, courts do not hesitate to uphold associational standing. *See, e.g.*, *Allied Tube and Conduit Corp. v. Latitude on the River Condo. Ass'n, Inc.*, 306 So.3d 312, 314 (Fla. Ct. App. 2020) (permitting "a class action by the association for a construction defect located physically within a unit, rather than

in the common elements, if the defect is prevalent throughout the building") (citation omitted).

E. The Restatement Confirms HOA Standing.

As noted above, § 6.11 of the Restatement (Third) is directly on point and recognizes HOA standing. If the Court finds Arizona's PDA and HADA statutes do not themselves confer statutory standing on Gallery HOA, the Court should adopt the Restatement's common-law standing rule.

"In the absence of controlling statutory or case authority, Arizona courts generally follow the Restatement of the Law on a particular subject if its position, as applied to the claim at issue, "is logical, furthers the interests of justice, is consistent with Arizona law and policy, and has been generally acknowledged elsewhere." *Freeman v. Sorchych*, 226 Ariz. 242, 247, ¶ 15 (App. 2011) (quoting *Ramirez v. Health Partners of S. Ariz.,* 193 Ariz. 325, 332, ¶ 26 (App. 1998) (citing *Ft. Lowell–NSS Ltd. P'ship v. Kelly,* 166 Ariz. 96 (1990); *Cannon v. Dunn,* 145 Ariz. 115, 116 (App. 1985)). "Further, Arizona courts routinely look to guidance from courts of other states on matters of first impression." *Freeman*, 226 Ariz. at 247, ¶ 15 (citing *Tritschler v. Allstate Ins. Co.,* 213 Ariz. 505, 513, ¶ 20 (App. 2006)); *see also Cannon v. Dunn,* 145 Ariz. 115, 116 (App. 1985) ("One of the reasons, if not the main reason that we follow the Restatement in the absence of prior Arizona

decisions, is that the Restatement is supposed to represent the general law on the subject in the United States.").

For example, our supreme court recently adopted the approach of the Restatement (Third) in construing servitudes, which provides that "[a] servitude should be interpreted to give effect to the intention of the parties ascertained from the language used in the instrument, or the circumstances surrounding creation of the servitude, and to carry out the purpose for which it was created." *Powell v. Washburn,* 211 Ariz. at 554, 556–57, ¶¶ 1, 13–14 (2006) (quoting Restatement (Third) § 4.1(1)). In so doing, the court abandoned the traditional common-law approach of strictly construing servitudes in favor of free alienability of land. While that older rule may have once served a valuable purpose, "Arizona courts may modify common law that appears unjust or out of step with the times." *Freeman*, 226 Ariz. at 247, ¶ 15 (citing *Villareal v. State Dep't of Transp.,* 160 Ariz. 474, 477, 774 P.2d 213, 216 (1989) (citing *City of Glendale v. Bradshaw,* 108 Ariz. 582, 584, 503 P.2d 803, 805 (1972)).

Likewise, in *Tierra Ranchos Homeowners Ass'n v. Kitchukov*, 216 Ariz. 195, 201 (App. 2007), this Court adopted Restatement (Third) § 6.13, which addresses the duties of a common-interest community association to its members. Under the Restatement approach, which is "intended to protect the legitimate expectations of members of common-interest communities" (§ 6.13 cmt. a), a member challenging

an action of the association bears the burden of proving that the association breached its duties. Those duties "grow out of the relationship created by servitudes between individually owned property and a common-interest community." *Id.* In addition, when the action is one within the association's discretion, the member bears "the additional burden of proving that the breach has caused, or threatens to cause, injury to the member individually or to the interests of the common-interest community." *Id.* The Court concluded:

> We find the Restatement approach to be well-reasoned and see no reason to adopt a different standard by which to review the discretionary decisions of a community association. *See* Scott B. Carpenter, Community Association Law in Arizona 157 (2d ed. 2005) (suggesting that Arizona courts should follow the Restatement (Third) of Property: Servitudes absent contrary authority in "cases that deal with community associations and restrictive covenants").

Id. at 202. So too here.

III. THE ATTORNEYS' FEES AWARD AGAINST GALLERY HOA SHOULD BE VACATED.

After it granted summary judgment against Gallery HOA, the trial court awarded substantial (and punitive) attorneys' fees against the HOA under § 12-341.01, including fees that had nothing to do with the standing defense on which summary judgment was granted, and that would not have been incurred at all had Appellees not inexcusably delayed raising this defense. [App. 95-100] It also granted fees to two third-party-defendant subcontractors that had not even timely

joined in KHov's summary judgment motion, and whose litigation expenses were entirely unnecessary to the order granting summary judgment. [IR-262, 264]

Because an award of fees in a case falling within the statute is discretionary, there is no presumption that the successful party is entitled to recover attorneys' fees. *Assoc. Indem. Corp. v. Warner*, 143 Ariz. 567, 569 (1985). Rather, a variety of factors are considered in reviewing a fee application. *Id*. A trial court's decision awarding or denying fees will not be reversed unless there has been an abuse of discretion or the award otherwise lacks a reasonable basis. *Id.*; *Bogard v. Cannon & Wendt Elec. Co.*, 221 Ariz. 139 (App. 2009).

Though the court had discretion to award fees under the statute, its analysis misstates or fails to account for critical facts bearing on its exercise of discretion, including, most importantly that: (a) the issue was one of first impression, (b) no prior Arizona authority had ever even questioned the standing of a planned community HOA to bring a construction defect "dwelling action" in these circumstances, (c) the Arizona PDA and HADA statutes themselves contemplate and appear to confer standing on *any* type of HOA to bring a "homeowners' association dwelling action," (d) the HOA's implied warranty claim was not without legal or factual merit (the merits were never even reached), and (e) given the total amount awarded ($358,235.72), and the amount that must be allocated to each of the 18 homeowners (nearly $20,000 each), the award of attorneys' fees in this case

would certainly discourage other parties from litigating legitimate claims. *Compare Fulton Homes v. BBP Concrete*, 214 Ariz. 566, 573, ¶ 31 (App. 2007) (finding $6,000 awarded against corporate general contractor to each of two third-party subcontractors "is not so exorbitant as to discourage meritorious claims").

The court's analysis of the *Warner* factors was also contradictory. On the one hand, the court concluded (incorrectly) that the claims involved no "complex or novel legal issues," but then acknowledged, on the other hand, with regard to the "previously adjudicated in this jurisdiction" factor, that, "Construction defect cases are common. There is no information as to whether the specific issues in this case have been previously adjudicated." [App. 97] The latter statement was correct; the former was not. It is simply not true that "[t]he dispositive legal issues had been addressed by the Arizona Supreme Court and Court of Appeals," as the court wrote. [App. 97] For this reason alone, the award should be vacated.

Therefore, unless the summary judgment order is reversed on the merits, in which case the fee award would also have to be reversed, the Court should vacate the fee award and remand for reconsideration so that the trial court may give due consideration to the factors under a correct understanding of the facts and law.

CONCLUSION

For the foregoing reasons, Gallery HOA respectfully requests that the Court reverse the entry of summary judgment and the award of attorneys' fees, and remand the case for further proceedings on the HOA's implied warranty claim.

DATED this 22nd day of September, 2023.

BURG | SIMPSON | ELDREDGE | HERSH | JARDINE PC
Craig S. Nuss
8310 South Valley Highway, Suite 270
Englewood, CO 80112

HOLDEN WILLITS PLC

By: */s/ Robert G. Schaffer*
Robert G. Schaffer
2 North Central Avenue, Suite 2000
Phoenix, AZ 85004

Attorneys for the Plaintiff Gallery Community Association