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When It All Has To Be Recorded: Court Of Appeal Permits Condominium Owner's Association Lawsuit To Proceed Against Developer For Self Dealing When Only Some, But Not All, Development Contracts Were Disclosed In The Covenants, Conditions & Restrictions

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As many are aware, under the Davis-Stirling Common Interest Development Act [see, Civil Code, § 4000, et seq.] ("Davis-Stirling Act"), "covenants and restrictions in the [Covenants, Conditions & Restrictions for a Common Interest Development] shall be enforceable equitable servitudes, unless unreasonable, and shall inure to the benefit of and bind all owners as separate interests in the development." [Civil Code, § 5975(a)] The California Courts of Appeal have also construed the Davis-Stirling Act to provide that there is a "statutory presumption of reasonableness [which] requires that recorded covenants and restrictions be enforced 'unless they are wholly arbitrary, violate a fundamental public policy, or impose a burden on use of affected land that outweighs any benefit.'" [See, Pinnacle Museum Tower Association v. Pinnacle Market Development (US), LLC (2012) 55 Cal. 4th 223, 239 ("Pinnacle Museum Tower Association"] This is significant as many developers of condominium projects have successfully inserted developer favored restrictions and agreements in Covenants, Conditions & Restrictions (sometimes herein, "CC&Rs") prior to the sale of any units and/or before control of the homeowners association's Board of Directors has passed to persons independent of the developer.

One question that has not been resolved is whether a developer's transaction which is partially disclosed in CC&Rs prior to the sale of any units, and which provides at least constructive notice of the existence of at least a portion of the developer's transaction, will serve to impose obligations on a homeowners association and its members once control of the Board of the homeowners association transfers over to independent homeowners.

That question has been answered in part in Market Lofts Community Association v. 9th Street Market Lofts, LLC (2014) 224 Cal. App. 4th 924 ("Market Lofts Community Association") where the California Court of Appeal, Second District, ruled that a developer's parking space sublicense agreement identified in Covenants, Conditions & Restrictions, and which provided at least

constructive notice of the existence of the parking space sublicense agreement, was enforceable against the homeowners association given that the parking space license agreement itself was not identified.

In Market Lofts Community Association, a condominium owners association brought an action against the condominium project's developers and an adjacent parking structure developer, seeking declaratory relief and alleging cause of action for breach of fiduciary duty, breach of parking license agreement, concealment, unfair business practices, and rescission of a recorded parking sublicense agreement. The Complaint alleged that the developers of the Market Lofts Condominiums, located near Staples Center in downtown Los Angeles, had entered into a parking space license agreement at an adjacent structure to the Market Lofts Condominiums. The Complaint further alleged that the parking space license agreement provided a perpetual license for the exclusive use of 319 spaces at no cost, except for an obligation to pay a proportionate share of common area maintenance charges. This occurred before the homeowners association was formally incorporated.

The homeowners association for the Market Lofts Condominiums was then formally incorporated a year later in January 2007 and the first sale of Market Lofts Condominium units occurred later that year. Shortly after the homeowners association was incorporated, the homeowners association, while controlled by the developers and the owners of the adjacent parking structure, entered into a "parking sub-license agreement" which provided a sublicense for the same 319 parking spaces on less favorable terms then the parking space license agreement. In that regard, the sublicense did not extend into perpetuity and required that the homeowners association pay a monthly fee of $75 for each parking space, to be increased annually by five percent, and then to be adjusted every ten years thereafter, to the prevailing market rate, irrespective of whatever the common area maintenance charges were. This resulted in compensation to the owner of the adjacent parking structure which was not contemplated by the original parking space license agreement.

In 2011, after control of the Board of the Market Lofts Condominiums owners association transferred to independent homeowners, suit was filed by the owners association for over $1 million in parking space payments that had been made under the parking space sublicense agreement, and which were not required under the parking space license agreement.

The Trial Court sustained a Demurrer Without Leave to Amend to the Complaint of the Market Lofts Condominiums owners association on the basis that, under the Davis-Stirling Act, the covenants and restrictions in the recorded Covenants, Conditions & Restrictions for the Market Lofts Project were not

wholly arbitrary or violated a fundamental public policy (the developers having argued that the holding in Pinnacle Museum Tower Association applied). On appeal, the Court of Appeal reversed. The Court of Appeal noted in its ruling that the developer was attempting to impose its vision of the application of the parking space license agreement which was not identified in the CC&Rs. The Court of Appeal further held that, while the CC&Rs did identify the parking space sublicense agreement, and that the homeowners had at least constructive notice of the existence of the parking space sublicense agreement, the Court further ruled that the homeowners association's Complaint was directed to the rights embodied in the parking space license agreement and "how those rights differed from what the Sub-License provided or the Developers' alleged self-dealing in systematically unraveling the rights in the License Agreement." The Court further ruled that, even assuming the Davis-Stirling Act applied, it did not provide the basis for sustaining the Demurrer Without Leave to Amend as the owners association had alleged sufficient facts in regard to self-dealing by fiduciaries of the owners association that potentially could have violated fundamental public policy.

The Market Lofts Community Association holding provides guidance with respect to what can and what cannot be construed as being enforceable against homeowners with respect to the documents and/or obligations set forth in Covenants, Conditions & Restrictions. In that regard, if a developer wishes to impose contractual obligations in the CC&Rs before the sale of any units (or prior to control of the Board being transferred to persons independent of the developer), it will likely have to disclose all of the documents which comprise any transaction which the developer wishes to embody as an obligation.

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