

# Consent, Coercion, and “Reasonableness” in Private Law: The Special Case of the Property Owners Association

ROBERT G. NATELSON\*

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\* Associate Professor of Law, University of Montana. A.B. Lafayette College, 1970; J.D. Cornell University, 1973; author of *LAW OF PROPERTY OWNERS ASSOCIATIONS* (Little, Brown & Co. 1989). Conversations with and comments by the following people were particularly helpful during preparation of this paper: James L. Winkur, Robert Ellickson, William L. Corbett, David deWolf, Michael Alan Wolf, Michael T. Gibson, Scott J. Burnham, Steven C. Bahls, and Elizabeth J. Natelson. I am grateful to Sylvia Harrison for her research assistance, to Charlotte Wilmerton for her secretarial support, and to Peter G. Dillon for introducing me to the works of Karl Llewellyn.

"My thesis is simple: with notice secured by recordation, freedom of contract should control."

— Richard Epstein<sup>1</sup>

"[Private] desires are social constructs."

— Cass Sunstein<sup>2</sup>

"It would be a heart-warming scene, a triumph of private attention to what is essentially private self-government . . . if only all businessmen and all their lawyers would be reasonable."

— Karl Llewellyn<sup>3</sup>

## I. INTRODUCTION

During the past two decades, legal scholars have clashed over the issue of whether private law questions ought to be analyzed in a paradigm of consent or in a paradigm of coercion. Illustrative of the controversy have been the debates on the fundamental nature of the law of land servitudes. Economic and traditional scholars have sided with the dominant judicial view that servitude law is consensual; critical legal scholars, on the other hand, have argued that servitude law is primarily or largely coercive.<sup>4</sup> Contestants on both sides have advanced their arguments in a matter largely abstracted from empirical study.<sup>5</sup>

Simultaneously, a revolution in American housing patterns has created a real-world model that can be employed to test the contentions on each side of the coercion/consent debate. The real-world model is the Property Owners Association (POA), an entity that during this period has emerged from the legal and social periphery to become a central feature of modern society.

Legally, a POA is but a private organization—one that manages and regulates a condominium or other common-interest housing subdivision.<sup>6</sup> Practically,

1. Epstein, *Notice and Freedom of Contract in the Law of Servitudes*, 55 S. CAL. L. REV. 1353, 1358 (1982) [hereinafter Epstein, *Notice*].

2. Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129, 1170 (1986).

3. K. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 362 (1960).

4. Among articles contending that servitudes and POA membership are consensual are Ellickson, *Cities and Homeowners Associations*, 130 U. PA. L. REV. 1519 (1982) [hereinafter Ellickson, *Cities*]; Epstein, *Covenants and Constitutions*, 73 CORNELL L. REV. 906 (1988) [hereinafter Epstein, *Covenants*]; Epstein, *Notice*, *supra* note 1; Reichman, *Judicial Supervision of Servitudes*, 7 J. LEGAL STUD. 139 (1978) [hereinafter Reichman, *Judicial Supervision*]; Reichman, *Residential Private Governments: An Introductory Survey*, 43 U. CHI. L. REV. 253 (1976) [hereinafter Reichman, *Residential*].

Among articles contending that servitudes and POA membership are coercive, or that the coercion/consent dichotomy is meaningless are Alexander, *Freedom, Coercion, and the Law of Servitudes*, 73 CORNELL L. REV. 883 (1988) and Frug, *Cities and Homeowners Associations: A Reply*, 130 U. PA. L. REV. 1589 (1982). For an article questioning the effectiveness of consent in many circumstances, see Winokur, *The Mixed Blessings of Promissory Servitudes: Toward Optimizing Economic Utility, Individual Liberty, and Personal Identity*, 1989 WIS. L. REV. 1, 56-62.

5. A notable exception is Professor Winokur. See generally Winokur, *supra* note 4.

6. As used in this article, a Property Owners Association (POA) is "an organization regulating and/or providing services for a land subdivision, which organization is created by covenants running with the land and whose membership consists of holders of units in the subdivision." R. NATELSON, *LAW OF PROPERTY OWNERS ASSOCIATIONS* 3 (1989). The term includes entities that govern condominiums and similarly interdependent subdivisions of the "town house," and "cluster home" varieties. It also includes traditional "homeowners' associations" regulating subdivisions of single family detached dwellings and entities governing commercial subdivisions, such as the business condominium association. However, the term *excludes* housing cooperatives and similar associations that stand in a tenurial relationship with their members.

it constitutes a form of private government whose rules, financial practices, and other decisions can be a powerful force for good or for ill in the lives of its members. As of 1988, those members included nearly thirty million Americans.<sup>7</sup>

POA decisionmaking, like decisionmaking by other private entities, is subject to judicial review. Under the standards that now prevail, the decisions of a POA must represent good faith efforts to further the purposes of its subdivision,<sup>8</sup> and if promulgated after a complaining owner has purchased a unit, they must constitute reasonable means of accomplishing such purposes.<sup>9</sup> POA decisions must be consistent with governing documents of superior force, and they must comply, as to both purpose served and means employed, with public policy.<sup>10</sup>

Most of the reported cases on POA decisionmaking focus on the reasonableness criterion.<sup>11</sup> When these cases are subjected not merely to traditional

7. As of 1988, 29,640,000 people lived in 130,000 "community associations," a term that excludes nonresidential POAs and includes housing cooperatives. COMMUNITY ASS'NS INST., COMMUNITY ASSOCIATIONS FACTBOOK 9 (1988) [hereinafter FACTBOOK]. Cooperatives represent only about five percent of the total. *Id.*

8. The purpose of the subdivision is determined primarily from its nature, the circumstances of its development, and recitals in its governing documents. The most important document is the declaration or master deed (often called the "declaration of conditions, covenants, and restrictions" or "CC&Rs"), a collection of servitudes and conditions invariably filed by the developer in the local recording office. The declaration sets forth the association's powers over the subdivision and describes all or some of the initial use restrictions. The recording of the declaration, coupled with the developer's simultaneous or subsequent sale of units in the subdivision, has the effect of imposing upon those units various easements and restrictive and affirmative covenants. Many if not most declarations have the additional effect of limiting the unit purchasers' estates in some way; in other words, they create future interests, usually executory interests. See R. NATELSON, *supra* note 6, at 55-60, 587-631.

The courts have expressly or impliedly validated a number of subdivision purposes, most relating to property protection and preservation. See, e.g., *Anthony v. Brea Glenbrook Club*, 58 Cal. App. 3d 506, 512, 130 Cal. Rptr. 32, 35 (1976) (enhancing the value of each home); *Rhue v. Cheyenne Homes, Inc.*, 168 Colo. 6, 8, 449 P.2d 361, 362 (1969) (protecting the present and future values of the properties); *Lyons v. King*, 397 So. 2d 964, 965 (Fla. Dist. Ct. App. 1981) (maintaining "a community of congenial residents who are financially responsible and thus protect the value of the apartments"); *Winslette v. Keeler*, 220 Ga. 100, 101, 137 S.E.2d 288, 289 (1964) (maintaining high quality of subdivision); *Drabinsky v. Sea Gate Ass'n*, 239 N.Y. 321, 329-30, 146 N.E. 614, 616-17 (1925) (maintaining the essential character of the inclosure as a private residential park or colony); *Lakemoor Community Club, Inc. v. Swanson*, 24 Wash. App. 10, 14, 600 P.2d 1022, 1025 (1979) (ensuring that a subdivision remains "a quiet, self-contained residential community").

Secondary purposes furthering primary goals also are common. See, e.g., *Riley v. Stoves*, 22 Ariz. App. 223, 228, 526 P.2d 747, 752 (1974) (eliminating noise associated with children so as to create a quiet and peaceful neighborhood); *Anthony*, 58 Cal. App. 3d at 511, 130 Cal. Rptr. at 34 (providing "well-kept clubhouse, recreational area and swimming pool" and "opportunities for playground activities and other forms of family and community recreation"); *Amoco Realty Co. v. Montalbano*, 133 Ill. App. 3d 327, 329, 478 N.E.2d 860, 862 (1985) (protecting and preserving "the distinctive qualities, amenities and characteristics of the area so that it would at all times be regarded as a residential community of outstanding excellence"); *Lakemoor*, 24 Wash. App. at 16-17, 600 P.2d at 1026 (enforcing restrictions to ensure development has road system closed to through traffic).

9. One distinguishes reasonableness review of the kind discussed here from the question of whether a POA regulation violates the rule against unreasonable restraints on alienation. See, e.g., *Seagate Condominium Ass'n v. Duffy*, 330 So. 2d 484 (Fla. Dist. Ct. App. 1976); *Franklin v. Spadafora*, 388 Mass. 764, 447 N.E.2d 1244 (1983).

10. R. NATELSON, *supra* note 6, at 123-53 (association rules), 171-73 (other POA decisions).

11. Despite intermittent scholarly and judicial attempts to pour content into the vessel of reasonableness review, there has not yet been systematic normative or economic study. There are two student notes focusing on reasonableness: Note, *Community Association Use Restrictions: Applying the Business Judgment Doctrine*, 64 CHI-KENT L. REV. 653 (1988) [hereinafter Note, *Use Restrictions*] and Note, *Judicial Review of Condominium Rulemaking*, 94 HARV. L. REV. 647 (1981) [hereinafter Note, *Condominium Rulemaking*]. Also relevant to the subject is Note, *The Rule of Law in Residential Associations*, 99 HARV. L. REV. 472 (1985) [hereinafter Note,

doctrinal analysis, but to economic study in the light of recent empirical research,<sup>12</sup> they offer a promising method for examining judicial response to consent and coercion in private law.

In the course of this Article, I reach several conclusions. One is that the empirical studies and the fact patterns of the cases reveal that POA decision-making contains elements of both coercion and consent. The precise mixture of the two varies according to temporal, market, cultural, and other factors. The courts enforce POA rules to which there has been genuine consent. When there is no genuine consent, they review those rules under a standard of "reasonableness." In this context, "reasonableness" means that the courts enforce POA decisions only when they can be integrated into a hypothetical bargain, a substitute for consent. Under the reasonableness standard, it is required that a POA decision be not merely efficient or utilitarian, but Pareto-superior.<sup>13</sup> This Article demonstrates that the judicial standard of Pareto superiority is not unique to the law of Property Owners Associations. It is utilized whenever one person or group exercises coercive control over the lives or property of others.<sup>14</sup>

For a decision to be Pareto-superior, it must be efficient, but not all efficient decisions are Pareto-superior. When a decision is efficient but not Pareto-superior, compensation can make it so. This Article explores the ways by which courts measure efficiency and compensation when there is no consent. It also examines judicial response when a POA decision cannot be integrated into a hypothetical bargain because it is difficult or impossible to measure compensation. The latter situation arises when a POA threatens an interest that is central to a unit owner's personhood.<sup>15</sup>

## II. FACTUAL AND LEGAL BACKGROUND

### A. *Functions of the Property Owners Association*

The POA may serve any of three overlapping, but separately identifiable, functions—the mediation, preservation, and community enhancement functions.

*Residential Associations*]. A few articles written by legal scholars have discussed the reasonableness criterion in the course of treating larger subjects: Ellickson, *Cities*, *supra* note 4; Natelson, *Keeping Faith: Fiduciary Obligations in Property Owners Associations*, 11 VT. L. REV. 421 (1986) [hereinafter Natelson, *Fiduciary*]; Reichman, *Judicial Supervision*, *supra* note 4; and Reichman, *Residential*, *supra* note 4.

12. The empirical studies are S. BARTON & C. SILVERMAN, COMMON INTEREST HOMEOWNERS' ASSOCIATIONS MANAGEMENT STUDY (Cal. Dep't Real Estate 1987) [hereinafter CALIFORNIA STUDY]; D. BENNEWITZ, CONDOMINIUM PROFILE: COMPREHENSIVE SURVEY FINDINGS AND RESULTS ON CONDOMINIUM ASSOCIATIONS AND THEIR OPERATIONS (Community Ass'ns Inst. 1986) [hereinafter CAI STUDY]; S. WILLIAMSON & R. ADAMS, DISPUTE RESOLUTION IN CONDOMINIUMS (Human Resources Management Center, College of Business Admin., Univ. N. Fla. 1987) [hereinafter FLORIDA STUDY]; R. Burby, Environmental Amenities and New Community Governance: Results of a Nationwide Study (Center for Urban and Regional Studies, Univ. N.C. 1974) (paper prepared for presentation at 5th Annual Conference of the Environmental Design Research Association (May 30 - June 1, 1974)); V. Walker, Striking the Balance: The Development of Social Control in Condominium Associations (Doctoral Dissertation, Nw. Univ. 1984).

13. Outcome *A* is said to be Pareto-superior to Outcome *B* if and only if at least one person is better off under *A* and nobody is worse off. R. POSNER, ECONOMIC ANALYSIS OF LAW 12 (3d ed. 1986). *See infra* notes 135-38 and accompanying text.

14. *See infra* Part IV. D.

15. *See infra* Part VII.

The *mediation function* consists of protecting the interests of individual members in their capacity as holders of individually held parcels of real estate—that is, in their capacity as unit owners.<sup>16</sup> Through its mediation activities, the POA protects unit holders from harmful externalities arising from other units.<sup>17</sup>

The primary legal tools of the mediation function are restrictive covenants, especially those controlling land use and architectural style.<sup>18</sup> The POA reduces the transaction costs<sup>19</sup> of covenant administration by serving as a central enforcement agency with accumulated experience and expertise. It also minimizes free rider problems by financing administration through mandatory assessments on members and provides parliamentary procedures by which covenants may be refined and modified without unanimous landowner approval. Thus, the POA reduces or eliminates multiparty negotiation and the concomitant dangers of wasted time, administrative expense, and holdouts.

The *preservation function* is the maintenance of existing common amenities and services. The word “preservation” emphasizes the conservative nature of this function. Preservation includes capital replacement, but does not otherwise encompass acquiring new property or constructing new amenities, nor does it include profit-making activities or other kinds of community promotion.

Before 1960, the typical association was limited to the mediation function, with perhaps a very few preservation activities. Most associations established in the last few decades, however, maintain a range of amenities. Examples are swimming pools, clubhouses, tennis courts, playgrounds, parks, exercise facilities, lakes, marinas, golf courses, roads, water and sewer lines, and even restaurants.<sup>20</sup> Most newer associations also offer a variety of services, sometimes related to the amenities, sometimes not. Examples are landscaping and other property maintenance, social functions, waste removal, community newsletters, cable television, bus transportation, child day care, nursery schools, and security

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16. As used herein, the term “unit” means an individually occupied lot or air space block. Unit often is defined to include also an appurtenant interest in *common elements*, i.e., co-owned common property. R. NATELSON, *supra* note 6, at 6.

17. See, e.g., R. Burby, *supra* note 12, at 11 (activities such as architectural review and maintenance).

18. Reichman, *Residential*, *supra* note 4, at 269-70. In more elaborate declarations, affirmative covenants and affirmative easements assist the mediation function. The most common affirmative covenants serving this purpose are those requiring unit owners or the association to undertake maintenance duties on particular lots and those requiring the members to pay periodic assessments in order to finance covenant administration and enforcement. *Id.* at 270-71, 273. The most common affirmative easements serving the mediation function are those granting agents of the POA access to particular units in order to prevent externalities. See, e.g., *River Terrace Condominium Ass'n v. Lewis*, 33 Ohio App. 3d 52, 514 N.E.2d 732 (1986) (access to unit to spray for cockroaches).

19. On the subject of the POA as a transaction cost avoider, see R. POSNER, *supra* note 13, at 59-60; Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681, 717 (1973) [hereinafter Ellickson, *Alternatives*]; and Reichman, *Residential*, *supra* note 4, at 292. Transaction costs are the costs involved in ordering economic activity through voluntary exchange. R. POSNER, *supra*, at 367.

20. For surveys of common amenities, see FACTBOOK, *supra* note 7, at 9; R. Burby, *supra* note 12, at 11-12; CALIFORNIA STUDY, *supra* note 12, at 8. The California Study, a survey of 579 POAs in that state, yielded typical results. Following is a list of amenities and the percentage of associations caring for each: Open space or lawns — 92%; park or playground — 84%; meeting place — 72%; parking lot or structure — 62%; swimming facility — 58%; roads — 43%; water or sewer lines — 42%; other recreational facility — 21%. *Id.* at 3, 8. Interestingly enough, POAs of middle size rather than large subdivisions are the most lavishly endowed with amenities. CAL STUDY, *supra* note 12, at 50 (the statement to the contrary, *id.* at 12, does not reflect the statistics provided). See also Reichman, *Residential*, *supra* note 4, at 255 (discussing amenities).

systems.<sup>21</sup> The legal mechanisms for carrying out these activities consist principally of easements and affirmative covenants, in conjunction with powers granted to nonprofit organizations by statutory and common law.<sup>22</sup>

The third discrete function is the *community enhancement function*. A POA performs the community enhancement function when it acquires additional real estate for parking, upgrades its heating system beyond replacement needs, lobbies for a zoning change that would increase the desirability of its property, or adopts an administrative rule designed to improve, rather than merely maintain, unit values. Affirmative covenants and statutory and common law association powers provide the legal basis for activities comprising the community enhancement function.

I have adopted the distinction between the preservation and community enhancement functions because it reflects a duality in judicial and public perceptions. Unit owners seem to expect preservation activity, but not community enhancement activity of the kind one would expect from a municipality or a business enterprise.<sup>23</sup> Courts adjudicating in this area have sought to reflect such public understanding.<sup>24</sup> They have, therefore, severely limited an association's power to engage in community enhancement activities.<sup>25</sup>

21. See CALIFORNIA STUDY, *supra* note 12, at 8; FACTBOOK, *supra* note 7, at 10; R. Burby, *supra* note 12, at 11. POA security systems internalize the value of the other amenities by preventing outsiders from using them. Ellickson, *Alternatives*, *supra* note 19, at 712.

22. Reichman, *Residential*, *supra* note 4, at 267-75, 279. Most commentators, including Dean Reichman, emphasize the servitude basis of association powers. See *infra* text accompanying note 43. However, some association services arguably do not touch and concern the land. Reliance on statutory and common law association and corporate powers eliminates doubts as to the POA's authority to, for example, publish a community newsletter.

Easements allow association access to the property to be maintained and unit owner access to the amenities to be enjoyed. Affirmative covenants impose various obligations on the association, and they establish the assessment mechanism. The assessment mechanism avoids free rider problems or, more precisely, avoids the transaction costs of determining who used what and how much each person should be paid for each service:

My own favorite example is riverboat pulling in China before the communist regime, when a large group of workers marched along the shore towing a good-sized wooden boat. The unique interest of this example is that the collaborators actually agreed to the hiring of a monitor to whip them.

... [T]he concept of shirking is, therefore, an indirect way of expressing that there is a cost in discovering prices for relative contributions.

Cheung, *The Contractual Nature of the Firm*, 26 J. L. & ECON. 1, 8-9 (1983).

23. On unit purchasers' conservative, risk-averse expectancies, see *infra* note 157. On the primacy of economic self-interest in condominium purchasers over group and social factors, see V. Walker, *supra* note 12, at 19, 28.

24. See, e.g., *Sterling Village Condominium, Inc. v. Breitenbach*, 251 So. 2d 685, 688 (Fla. Dist. Ct. App. 1971): "Daily in this state thousands of citizens are investing millions of dollars in condominium property. [The applicable statute] and the Articles or Declarations of Condominiums provided for thereunder ought to be construed strictly to assure these investors that what the buyer sees the buyer gets."

25. Judicial opinions sometimes recite governmental-type purposes set forth in POA covenants, such as "promoting the general welfare of the residents," see, e.g., *Ryan v. Baptiste*, 565 S.W.2d 196, 197 (Mo. Ct. App. 1978) ("for the health, comfort, safety, and general welfare of the unit owners and occupants of said property"), but I see little evidence that courts take such language seriously. Not all courts will grant such purposes even nominal recognition. See, e.g., *Beech Mountain Property Owners' Ass'n v. Seifart*, 48 N.C. App. 286, 269 S.E.2d 178 (1980).

A series of Florida cases reflects the prevalent judicial attitude. Relying in part on a statute prohibiting amendments to the declaration that materially alter a condominium unit without unanimous owner approval, FLA. STAT. ANN. § 718.110(4) (West 1988), the Florida courts have prohibited community enhancement activities in several cases. See *Downey v. Jungle Den Villas Recreation Ass'n*, 525 So. 2d 438 (Fla. Dist. Ct. App. 1988) (prohibiting acquisition of real estate and construction of new swimming pool); *Rothenberg v. Plymouth No. 5 Condominium Ass'n*, 511 So. 2d 651 (Fla. Dist. Ct. App. 1987) (prohibiting establishment of bus service); Is-

Through its preservation and community enhancement activities the association offers its members the same advantage available to the shareholders of a business firm: replacement of high contract costs with lower agency costs. Although similar amenities and services are available on the open market, the association enables the members to avoid the costs of the market price mechanism. These costs, as Professor Cheung has observed,<sup>26</sup> consist primarily of the expense of discovering what the relevant prices are. Without an association, the members would have to investigate each of the large number of amenities and services available in modern society, learn enough about each amenity and service to be able to understand its pricing, appraise different services provided by the same supplier (as when a single maintenance person both mows lawns and repairs plumbing), and assess the respective contributions of each participant in a single project. By purchasing a unit in a subdivision governed by a Property Owners Association, the owner receives the entire panoply of services in exchange for one periodic monthly assessment.

### B. *Context of POA Decisionmaking and Judicial Review*

The scope of the association's mediation, preservation, and community enhancement functions is delineated initially in a declaration or master deed prepared by legal counsel for the subdivision developer and recorded prior to the sale of the first unit. The declaration is a collection of servitudes and conditions governing the subdivision's property law regime. The structure of the POA itself and the procedures under which it will exercise its functions are set forth in articles of association or articles of incorporation and in bylaws, also prepared by the developer's attorney. In addition to the procedural content typical of corporate bylaws, POA bylaws often contain further use restrictions, and these bylaws may be recorded along with the declaration.

Day-to-day subdivision governance is entrusted to a board of directors, which may be called by that name or by some analogous title.<sup>27</sup> Most POA decisionmaking is effectuated through that board, in the form of either administrative rules or ad hoc resolutions. In the course of its duties the board may establish rules for clubhouse use, limit the number of pets in a unit, set the level of financial assessments imposed on each unit, approve or reject an application for a building permit, or vote to construct a new tennis court. The general membership also has inherent rulemaking power through its ability to change the bylaws, articles, and declaration.

The extent of the decisionmaking power differs according to the nature of the particular subdivision. In subdivisions of individually owned single-family homes, POA authority may be quite limited. In subdivisions that are highly interdependent legally (such as condominiums) or architecturally (such as

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landia Condominium Ass'n v. Vermut, 501 So. 2d 741 (Fla. Dist. Ct. App. 1987) (prohibiting alteration of original exterior color scheme); Ocean Trail Unit Owners Ass'n v. Levy, 489 So. 2d 103 (Fla. Dist. Ct. App. 1986) (prohibiting acquisition of real estate). See also Zaid v. Island House Condominium Ass'n, 170 N.J. Super. 206, 406 A.2d 196 (Ch. Div. 1979) (prohibiting POA brokerage activities).

26. Cheung, *supra* note 22, at 6-8.

27. *E.g.*, "board of managers."

apartment buildings), POA regulatory schemes are intense and the decision-making power quite significant.<sup>28</sup>

C. *Previous Efforts to Define the Standards for Judicial Review*

The POA decisionmaking power is subject to abuse. A POA may promulgate a decision that is unfairly discriminatory or may adopt a resolution without rational foundation, adequate investigation, or notice to the members.<sup>29</sup> The potential for abuse and the relative lack of decided cases in the area have induced courts and commentators to cast in various directions for precedents appropriate to review of POA decisionmaking.

For the most part, these courts and commentators have proceeded by scanning the legal landscape for situations similar to POA decisionmaking and for entities similar to POAs in the hope of identifying some substantial body of precedent that can be incorporated into POA law *en masse*. In the process, individual courts and commentators have resorted to public law and constitutional standards,<sup>30</sup> judicial review of the developer's exercise of reserved pow-

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28. Various empirical data support the intuitive view that the intensity of POA power increases as unit interdependence increases. Thus, CAI STUDY, *supra* note 12, which surveyed condominiums only, reported higher assessment levels for high rises and medium rises than for single family homes, townhouses, or garden apartments. *Id.* at 17, 66. The sample of single-family home condominiums was too small to be statistically significant, but in other subdivisions there was a strong correlation between architectural interdependence and intensity of regulation. For example, POAs governing high and midrise buildings were more likely to charge one-time rental fees, *id.* at 34, and only 16.4% of high and medium rises (the smallest of any group) had no age, right of first refusal, or pet restrictions.

Following is the percentage of each architectural group with surveyed regulations. These figures were obtained by manipulation of tables, *id.* at 67.

<i>Rights of first refusal</i>	
High and medium rises .....	45.4%
Garden apartments .....	31.7%
Townhouses .....	33.5%
<i>Pet restrictions</i>	
High and medium rises .....	58.0%
Garden apartments .....	54.8%
Townhouses .....	39.0%
<i>Age or child restrictions</i>	
High and medium rises .....	21.0%
Garden apartments .....	23.0%
Townhouses .....	9.9%
<i>Move-in fee</i>	
High and medium rises .....	28.6%
Garden apartments .....	14.4%
Townhouses .....	9.9%

29. See, e.g., Reichman, *Residential*, *supra* note 4, at 274-75 (fearing possibility of abuse by discriminatory regulations and discriminatory application of facially fair regulations); Note, *Condominium Rulemaking*, *supra* note 11, at 648 (same); Note, *Residential Associations*, *supra* note 11, at 473-78 (fearing "illiberal" associations that do not respect societal norms of civil liberties).

30. Weakland, *Condominium Associations: Living Under the Due Process Shadow*, 13 PEPPERDINE L. REV. 297 (1986); Note, *Residential Associations*, *supra* note 11.



ers,<sup>31</sup> trust law,<sup>32</sup> and the laws of business corporations<sup>33</sup> and housing cooperatives.<sup>34</sup>

Resort to public law standards has not been notably successful. Precedents applicable to governmental decisionmaking do not apply very well to POAs, and not merely, as one commentator has suggested, because submission to a POA is "perfectly voluntary," while submission to government is imperfectly so.<sup>35</sup> Courts probably should not defer to POA economic regulation to the extent they defer to governmental economic regulation, nor should they impose a single regulatory framework (due process, for example) on all POAs.<sup>36</sup> Moreover, the analogy of the POA to government disregards both the distinction between state and private action and other important differences between POAs and government: the tiny size of most POAs (a median of forty-three units, according to one recent survey);<sup>37</sup> their narrow range of functions, at least compared to general governments;<sup>38</sup> and the absence of the redistributive,<sup>39</sup> police, conscriptive, general welfare taxation, and enforcement privileges characteristic of sovereign power.<sup>40</sup> Even the closest governmental analogue, the special district, often differs from the POA in significant ways. Unlike POAs, most special districts de-

31. The term "discretionary servitudes" is employed by Reichman, *Judicial Supervision*, *supra* note 4, at 139 n.1; and Reichman, *Residential*, *supra* note 4, at 279. For other writings adopting this analysis, see R. NATELSON, *supra* note 6, at 120-23; Rose, *Servitudes, Security, and Assent: Some Comments on Professors French and Reichman*, 55 S. CAL. L. REV. 1403, 1408-09 (1982).

32. Reichman, *Residential*, *supra* note 4, at 296.

33. See *infra* notes 51, 54.

34. *E.g.*, *Dulaney Towers Maintenance Corp. v. O'Brey*, 46 Md. App. 464, 418 A.2d 1233 (1980).

35. Ellickson, *Cities*, *supra* note 4, at 1520.

36. Dean Reichman itemizes a number of objections to the public law analogy. His objections include the lack of connection between government and most POAs; the fact that the POA is more nearly voluntary than government, *accord* Note, *Condominium Rulemaking*, *supra* note 11, at 657; the argument that imposition of a single regulatory framework upon all POAs would increase gravitation toward central control and uniformity of conduct; if public law were not made applicable to all POAs, the difficulty of determining the dividing line; the difficulty of determining whether all forms of administrative law are relevant or only constitutional norms; the difficulty of determining the proper consequences of a POA decision not meeting public law norms; and potentially grave consequences for the autonomy of other private organizations. Reichman, *Residential*, *supra* note 4, at 255-56, 276-78.

37. CALIFORNIA STUDY, *supra* note 12, at 7. The authors admitted a sample bias toward larger subdivisions—meaning the actual median is probably smaller. Although legal attention tends to focus on megacommunities, see, *e.g.*, *Rancho Santa Fe Ass'n v. United States*, 589 F. Supp. 54 (S.D. Cal. 1984), other surveys confirm the dominance of much smaller subdivisions. See, *e.g.*, FLORIDA STUDY, *supra* note 12, at 53 (median of 35 owners); FACTBOOK, *supra* note 7, at 3 (median of 95 owners; survey may be biased to larger POAs because of CAI membership base). Moreover, there is a trend toward building smaller association subdivisions. CAI STUDY, *supra* note 12, at 8, 48; CALIFORNIA STUDY, *supra* note 12, at 7.

38. Not only do most governments control far more functions than do POAs, but larger POAs (those most difficult to exit) control fewer functions than do those that are intermediate in size. CAI STUDY, *supra* note 12, at 50.

39. *Thanasoulis v. Winston Towers 200 Ass'n*, 110 N.J. 650, 542 A.2d 900 (1988); Ellickson, *Cities*, *supra* note 4, at 1524-26; *accord* Reichman, *Residential*, *supra* note 4, at 285.

40. Disobedience of government regulation entails fines, imprisonment, even death. The POA, of course, has no imprisonment or execution power, and its fining capacity is limited severely by its operative documents and by what the instruments of government are willing to enforce. *Cf. Unit Owners Ass'n of Buildamerica-1 v. Gillman*, 223 Va. 752, 292 S.E.2d 378 (1982) (POA fines set aside as a privilege of government sovereignty); CALIFORNIA STUDY, *supra* note 12, at 23 (most POAs do not levy fines; most fines where levied range from \$25 to \$100).

POA enforcement mechanisms in general are inefficient compared to those available to government. The primary mechanism of the POA, assessment liens, hardly can be compared to government's ready access to fire-power and moral propaganda.

liver a single service (fire, water, sewer), but exercise sovereign power within the scope of their duties (the emergency prerogatives of the fire department, for example). Further, with the notable exception of school districts, the managers of most special districts (unlike the directors of POAs) are not elected by the people they serve.

Because of these and other difficulties with applying public law standards, most courts and commentators have rejected those standards in favor of one or more private law analogies.<sup>41</sup> As we shall see, certain underlying principles of private law have been applied successfully in reviewing POA decisions.<sup>42</sup> Unfortunately, some courts and commentators have lost sight of these underlying principles in the course of borrowing rules from other contexts. Because of the differences between POAs and those other contexts, rules that further underlying principles elsewhere may not further those principles in POAs. Following is a brief review of some of the private law models courts and commentators have employed as sources of POA law and the distinctions that create difficulties for those attempting to borrow rules *en masse*.

Some commentators resort to the law of land servitudes as a source of standards for POA review. A particular favorite is the discretionary servitude concept, whereby courts sustain a developer's reservation of power to alter a servitude scheme, but subject exercises of the reserved power to reasonableness review.<sup>43</sup> Discretionary servitude rules suffer a number of limitations in the POA context, however. First, the management model is different: a developer, unlike a POA board of directors, does not stand for re-election at regular intervals. More importantly, the discretionary servitude doctrine is inadequate to assess the full scope of the decisionmaking power of the modern POA. Discretionary servitude cases are invariably mediation function cases, and they tell us little about review in the context of the preservation and community enhancement functions. Finally, discretionary servitude doctrine is hemmed in with the restrictions of traditional servitude law. For example, traditional law provides that covenants must touch and concern the land. This requirement poses no problems in assessing a rule that defines the permissible hours for swimming pool use. But an earnest application of the touch and concern test might lead to invalidation of important and otherwise legitimate POA decisions, such as those pertaining to social events off the premises, cable television service, the associa-

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41. See, e.g., Ellickson, *Cities*, *supra* note 4; Reichman, *Residential*, *supra* note 4, at 276-77; Note, *Condominium Rulemaking*, *supra* note 11, at 657-58. For a general discussion and citation of case law, see R. NATELSON, *supra* note 6, at 487-92.

42. See *infra* Part IV.

43. The most common reservation is architectural review of proposed improvements—a mediation function. When the POA is involved, its rights are based on its status as the developer's assignee. Illustrative cases are *Davis v. Geyer*, 151 Fla. 362, 9 So. 2d 727 (1942); *Winslette v. Keeler*, 220 Ga. 100, 137 S.E.2d 288 (1964); *Amoco Realty Co. v. Montalbano*, 133 Ill. App. 3d 327, 478 N.E.2d 860 (1985); *Town & Country Estates Ass'n v. Slater*, 227 Mont. 489, 740 P.2d 668 (1987); *Carranor Woods Property Owners' Ass'n v. Driscoll*, 106 Ohio App. 95, 153 N.E.2d 681 (1957); *Lakemoor Community Club, Inc. v. Swanson*, 24 Wash. App. 10, 600 P.2d 1022 (1979).

tion newsletter, or bus service.<sup>44</sup> Thus, discretionary servitude precedent offers limited usefulness in reviewing POA decisionmaking.

Another private law analogy is the fiduciary trust.<sup>45</sup> This analogy offers the advantage of taking into account the POA's preservation function and the risk-adverse expectancies of its membership. Trust law also provides rules governing mediation between holders of nonfungible interests.<sup>46</sup> The shortcomings of the trust law analogy are that trust rules must take into account a nondemocratic form of management, that trust beneficiaries often are children, and that exit is more difficult for a trust beneficiary than for a POA member. Because of the needs of the trust context, the standards of judicial review of a trustee's decisions are probably more strict than is appropriate for review of association decisions. On occasion, the trust model has proven deceptive, as has been the case in litigation between unit purchasers and subdivision developers.<sup>47</sup>

The private law analogue to the POA most often suggested is the business corporation. This, however, is a model fraught with difficulties. The relative fungibility of shares in most corporations, at least in publicly traded firms, means that mediation issues are of much less significance than in the POA context.<sup>48</sup> Moreover, corporate shareholders enjoy more opportunities for easy exit than do POA members because most corporate stock is readily marketable and most shareholders have relatively small individual stakes.<sup>49</sup> Bearing fairly close comparison to review of POA decisions are those rare cases in which a court has reviewed corporate bylaws for reasonableness when those bylaws would injure

44. For an old case involving a forerunner of bus service, see *Lyford v. Northern Pac. Coast R.R. Co.*, 92 Cal. 93, 28 P. 103 (1891) (promise to provide free railroad service to adjoining owner held not to run with land). Dean Reichman would require POA regulations to touch and concern. Reichman, *Residential*, *supra* note 4, at 293-94. Arguably, however, the savings in transaction costs in the POA servitude modification mechanism justifies dispensing with the touch and concern rule in this context. *But see Sterk, Foresight and the Law of Servitudes*, 73 CORNELL L. REV. 956 (1988) (high transaction costs of changing servitudes justify touch and concern test).

45. Dean Reichman, among others, has suggested recourse to this model. Reichman, *Residential*, *supra* note 4, at 296.

46. *See infra* note 141 and accompanying text.

47. R. NATELSON, *supra* note 6, at 450-77.

48. *See Ellickson, Cities*, *supra* note 4, at 1534-35 n.61:

Business shares are generally homogeneous in quality. . . . Moreover, business shareholders tend to have a single common purpose: maximizing the value of their shares. . . . Because shareholders of a widely held corporation tend to have common interests, a majority of shareholders cannot easily enrich itself at the expense of a minority. . . .

By contrast, because of the uniqueness of real estate and the emotional ties that bind one to one's residence, an association member may have a reservation price well above market price. The member will thus consider the effect of an amendment not only on the market value of his unit, but also on his subjective valuation of the unit. More importantly, every unit has a unique location and almost certainly other unique features as well. These two heterogeneities—in owners' valuations and in quality of units—make it more likely that an association's amendments (compared to a business corporation's amendments) will seriously disgruntle a minority.

On protection from discrimination potential due to unit owner heterogeneity, see Epstein, *Covenants*, *supra* note 4, at 922-26.

49. Contrast the typical POA unit owner with the following:

The typical shareholder (except in the closely held corporation or where one shareholder owns a very large percentage of the shares of the corporation) is not knowledgeable about the business of the firm, does not derive an important part of his livelihood from it, and neither expects nor has an incentive to participate in its management. He is a passive investor and, because of the liquidity of his interest, has only a casual and often a transitory relationship with the firm.

R. POSNER, *supra* note 13, at 383.

some shareholders disproportionately.<sup>50</sup> Those cases, however, have been disregarded in the search for paradigms for review of POA decisions. Instead, courts and commentators have resorted to the business judgment rule.<sup>51</sup> Yet the business judgment rule is a doctrine employed to insulate officials from liability for their acts; it is not a standard of validity.<sup>52</sup> Moreover, at least in its common law form, the business judgment rule is founded upon principles of enterprise liability totally inappropriate for review of the preservation and mediation functions of the POA.<sup>53</sup> It is hardly surprising, therefore, that despite their stated reliance upon the rule, the courts that purport to apply it to POAs actually impose reasonableness standards substantively indistinguishable from those utilized in other POA review cases.<sup>54</sup>

The closely held corporation is potentially available as a private law analogue to the POA, although commentators seem to have overlooked close corporation law as a source of POA rules. The law of close corporations does address mediation and other issues of the kind common to those entities and to the

50. These cases tend to arise in non-profit, mutual benefit settings. 8 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 4177, 4191, 4195 (rev. perm. ed. 1982 & Supp. 1989). See *Lambert v. Fishermen's Dock Coop.*, 61 N.J. 596, 600, 297 A.2d 566, 568 (1972) ("It is the law generally that a reserved right to amend the by-laws of an association . . . is a limited rather than an absolute right, even though the reservation is expressed in broad and general terms.").

51. Among commentators, see, e.g., Note, *Use Restrictions*, *supra* note 11; Note, *Condominium Rulemaking*, *supra* note 11. Among cases, see, e.g., *Rywalt v. Writer Corp.*, 34 Colo. App. 334, 526 P.2d 316 (1974); *Farrington v. Casa Solana Condominium Ass'n*, 517 So. 2d 70 (Fla. Dist. Ct. App. 1987); *Yorkshire Village Community Ass'n v. Sweasy*, 170 Ill. App. 3d 155, 524 N.E.2d 237 (1988); *Papalexiov v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979).

52. Dean Clark defines the business judgment rule as follows:

The rule is simply that the business judgment of the directors will not be challenged or overturned by courts or shareholders, and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply. Put another way, the rule is "a presumption that in making a business decision, the directors of a corporation acted on an informed basis in good faith and in the honest belief that the action was taken in the best interests of the company."

R. CLARK, CORPORATE LAW 123-24 (1986) (quoting *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984)).

53. The objections to applying the business judgment rule to POAs, at least in its pure enterprise liability form, are discussed at length in Natelson, *Fiduciary*, *supra* note 11.

The author of the 1981 Note on Condominium Rulemaking favors the business judgment rule because (1) it avoids the public law problems of the constitutional and administrative analogies; (2) it can be used to implement procedural fairness; and (3) "formally adopting the general corporate analogy will add an element of predictability to condominium rulemaking, permitting condominium associations and their counsel to refer to the extensive case law concerning the application of the business judgment rule to corporate decisionmaking." Note, *Condominium Rulemaking*, *supra* note 11, at 663-66.

However: (1) As noted in the text, there are significant differences in function and structure between Property Owners Associations and profit corporations, and even when the business judgment rule is purportedly applied in nonprofit organizations, the usual standard is one of reasonable care rather than of gross negligence or fraud. W. KNEPPER, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS 228-29 (3d ed. 1978). (2) Procedural review does not depend on the business judgment rule. Courts have implemented procedural review in non-business judgment rule cases, e.g., *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977), and have disclaimed procedural review in business judgment rule cases, e.g., *Rywalt v. Writer Corp.*, 34 Colo. App. 334, 526 P.2d 316 (1974). (3) Adoption of misleading precedents from another kind of enterprise is hardly an advantage.

54. *Rywalt v. Writer Corp.*, 34 Colo. App. 334, 526 P.2d 316 (1974); *Farrington v. Casa Solana Condominium Ass'n*, 517 So. 2d 70 (Fla. Dist. Ct. App. 1987); *Leppaluoto v. Warm Springs Hollow Homeowners Ass'n*, 114 Idaho 3, 752 P.2d 605 (1988); *Yorkshire Village Community Ass'n v. Sweasy*, 170 Ill. App. 3d 155, 524 N.E.2d 237 (1988); *Papalexiov v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979).

POA.<sup>55</sup> To this extent, adoption of close corporation rules in POA law would more perfectly apply underlying principles than would adoption of rules applicable to some other organizations.<sup>56</sup> On the other hand, there are enough differences between close corporations and POAs to discourage borrowing close corporation rules *en masse*.<sup>57</sup>

The law of cooperative associations represents yet another potential source of rules. The housing cooperative, the most obvious analogue, presents difficulties because of the tenurial relationship between the cooperative association and its membership and because of the greater financial interdependence among the members themselves.<sup>58</sup> Cooperative associations with more promise—specifically, agricultural cooperatives and other mutual benefit societies—are never mentioned as a source of rules for POA law. They represent, however, the closest analogue of all, and several important marketing cooperative cases apply rules very similar to those adopted in reviewing decisions of POAs.<sup>59</sup>

The fault in previous efforts to define the standard of review of POA decisionmaking lies in the notion that one may search for a single analogue, a particular entity or concept, that is so “like” the POA that the law governing the analogue can be transferred wholesale to the POA. In fact, however, the POA is *sui generis*, and the law must treat it as such: a multiple-function private organization dedicated to preservation and mediation, democratically operated, and composed of (usually unsophisticated) members with large, nonfungible investments for whom entrance is always readily avoidable and exit is difficult but not impossible. In the American legal environment, there is nothing else quite like it.

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55. The close corporation shares several characteristics with the POA that represent differences from the publicly-traded corporation. These include relative illiquidity of shares, the investors' lack of appreciation of the risks of entering the venture, the investors' enthusiasm and relatively weak bargaining position, the significant portion of the investors' assets invested in the venture, and the practice of entering into the venture without legal advice. *Matter of Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 71-72, 473 N.E.2d 1173, 1178-79, 484 N.Y.S.2d 799, 804-05 (1984); *Meiselman v. Meiselman*, 309 N.C. 279, 289-91, 307 S.E.2d 551, 558-59 (1983).

56. *See infra* note 142.

57. Unlike the shares of a close corporation, an interest in a POA usually is freely alienable or subject to only minimal transfer restraint. Most POAs have no restraints on alienability of units, except, for obvious reasons, covenants against partition of a condominium. When restraints exist, they usually are rights of first refusal or age limitations. Age limitations against families with children (except in retirement communities) were invalidated by 1988 amendments to the federal Civil Rights Act of 1968. Fair Housing Amendments Act, Pub. L. No. 100-430, § 6, 102 Stat. 1620-23 (1988). The severe restraints typical of housing cooperatives are rare in POAs. On transfer restraints in POAs, see R. NATELSON, *supra* note 6, at 593-610.

58. For judicial recognition of the differences between co-ops and POAs, see *Sanders v. The Tropicana*, 31 N.C. App. 276, 229 S.E.2d 304 (1976). Another potential analogy is the labor union, especially the industrial union, membership in which is a condition of employment. Labor unions, however, are subject to extensive statutory and administrative regulation and serve public law goals. Individual interests may be sacrificed to the policy of furthering *collective* bargaining. For a discussion of the policy behind the federal labor statutes, see H. WELINGTON, *LABOR AND THE LEGAL PROCESS* 38-46 (1968). For a survey of the limited protections afforded nonfungible minorities in labor unions, see D. BOK & J. DUNLOP, *LABOR AND THE AMERICAN COMMUNITY* 112-16 (1970).

59. *See infra* note 143. The analogy is not perfect. For example, as the case names suggest, cooperators usually are business people with more sophistication in their enterprises than homeowners have in real estate. Also, because these are business cooperatives, community enhancement functions play more of a role than in POAs.

### III. PRE-EXISTING REGULATIONS: COERCION AND CONSENT

#### A. *An Overview of the Consent/Coercion Debate*

Modern courts often justify servitude provisions, including grants of discretionary power to associations, on the basis that members consented to those provisions when they purchased their units.<sup>60</sup> As noted in the Introduction to this Article, however, the question of whether property purchasers actually consent to pre-existing servitudes (including the association's decisionmaking power) is a controversial one. The consent theory rests upon the observation that purchasers pay for, and accept deeds to, parcels of land while on legal notice of encumbrances purporting to bind possessors of the land.<sup>61</sup> We may reduce this justification to an equation:

$$\text{Acceptance of deed} + \text{Notice} = \text{Consent}$$

Professor Richard Epstein is perhaps the leading proponent of consent theory.<sup>62</sup> Professors Gerald Frug and Gregory Alexander, on the other hand, are skeptical of it. They assert that at least in this context, distinctions between consent and coercion and between private and public powers are illusory.<sup>63</sup> To illustrate his point that "this public/private distinction is hypothesis and nothing more,"<sup>64</sup> Frug observes that Professor Ellickson, a consent theory proponent,<sup>65</sup> favors compensation arrangements for association "takings" and adds:

Since a taking clause would seem an unlikely suggestion for an association truly envisioned as private (such as the family), recommendation of such a clause for the homeowners association indicates that [Ellickson] envisions these groups as having qualities generally associated with public organizations. Like Locke, Professor Ellickson seems to recognize that the governing board of even a 'purely voluntary' association is invested with power that can threaten the association's members. . . . Professor Ellick-

60. For cases relying on the consent or contract theory in this context, see, e.g., *Winslette v. Keeler*, 220 Ga. 100, 137 S.E.2d 288 (1964); *Ryan v. Baptiste*, 565 S.W.2d 196 (Mo. Ct. App. 1978); *Warren v. Del Pizzo*, 46 Or. App. 153, 611 P.2d 309, *modified on other grounds*, 48 Or. App. 237, 616 P.2d 1186 (1980); *Sea Pines Plantation Co. v. Wells*, 294 S.C. 266, 363 S.E.2d 891 (1987). Cf. *Coquina Club, Inc. v. Mantz*, 342 So. 2d 112 (Fla. Dist. Ct. App. 1977) (unit owners took subject to the covenants, including a provision permitting the association to issue reasonable rules and regulations).

61. Epstein, *Covenants*, *supra* note 4, at 914 ("It is *both* the decision to purchase and the notice that constitute the consent, not either in isolation from the other.").

62. Epstein believes that the recording system enables us to discard safely certain traditional servitude limitations, such as the touch and concern test, which were designed to ensure notice before the advent of the recording system. Epstein, *Notice*, *supra* note 1; Epstein, *Covenants*, *supra* note 4.

63.

Choice and coercion are not alternative objective social states that either exist or do not exist. Rather they are rhetorics that, though contradictory, are both always available as interpretations of any given social experience. Pretending that they are more than just opposing rhetorics creates a form of nominalism that privileges one understanding, one interpretation. Alexander, *supra* note 4, at 884.

64. Frug, *supra* note 4, at 1590.

65. See Ellickson, *Cities*, *supra* note 4, at 1520: "Although cities are considered 'public' and homeowners associations 'private,' I discern only one important difference between the two forms of organization—the sometimes involuntary nature of membership in a city versus the perfectly voluntary nature of membership in a homeowners association."

son apparently has no trouble in applying public law to the governance of a homeowners association with at least the severity he would apply it to cities.<sup>66</sup>

Professors Frug and Alexander attack the validity of both elements on the left side of the "Acceptance + Notice = Consent" equation. Frug implies that acceptance of a servitude plan would be voluntary only if it "come[s] into existence by the voluntary agreement of the original settlers" rather than by voluntary purchase from a common developer who sets it up and offers it to the public.<sup>67</sup>

Alexander argues more explicitly that acceptance by deed may not be real acceptance. He notes that each servitude is "bundled" with real estate and, in the modern covenanted subdivision, with many other servitudes. This, he suggests, reduces the purchaser's right to select among available terms. Bundling also impairs the existing owner's ability to exit and thus limits his continuing assent:

Exit is at best an imperfect strategy for disgruntled land owners because the immobility of their asset limits their options. They can convert their land to capital by selling it, but selling represents capitulating on the very matter at issue: to be able to use *their* land free from the unwanted height restriction. To keep the land, they must comply with the restriction (grudging loyalty); to avoid the restriction they must give up the land (exit).<sup>68</sup>

According to Alexander, purchaser ignorance of the market further restricts choice. He asserts that many purchasers believe that "ownership in a residential development without a particular restriction is unavailable. The consequences of this pervasive belief is that one cannot simply assume that restrictions are included in deeds because purchasers want them there."<sup>69</sup> Maximizing the auton-

66. Frug, *supra* note 4, at 1591-92. The suggestion that the compensation principle is exclusively, or even primarily, a public law principle is erroneous. See *infra* note 147 and accompanying text.

67. Frug, *supra* note 4, at 1590.

68. Alexander, *supra* note 4, at 888. Cf. Frug, *supra* note 4, at 1591 ("Once a homeowner is in place, any rule made by the governing board not authorized by the original agreement threatens him with coercion.")

69. This statement is a reflection of the hypothesis of "adaptive preferences," a hypothesis relied upon by critical legal scholars. The principle of adaptive preferences is that some preferences arise because what people want is unavailable. Sunstein, *supra* note 2, at 1146-50. The hypothesis is based largely on a misreading of the fable of the fox and the grapes, resulting in the questionable conclusion that once the fox "decided" the grapes were sour, he would not have taken them even if they had become available. Cf. *id.* at 1149.

The fable actually stands for a view diametrically opposed to that propounded by the writers who rely on it as an illustration of adaptive preferences. The message of those writers is that people are the captives of circumstance. The full text of Aesop's story is as follows:

A hungry fox tried to reach some clusters of grapes which he saw hanging from a vine trained on a tree, but they were too high. So he went off and comforted himself by saying: "They weren't ripe anyhow."

In the same way some men, when they fail *through their own incapacity, blame circumstances.*

FABLES OF AESOP 5 (Penguin 1954) (emphasis added).

It is doubtful whether adaptive preferences can be called preferences at all. If the phenomenon is important in the economic world (and its proponents offer little empirical evidence that it is beyond the mere existence of the fable), it probably reflects (as Aesop suggests) only an accommodation to the universal fact of economic scarcity, a rationalization employed to cope with frustration. I suspect that when the scarcity disappears, the "preference" virtually always disappears.

Professor Sunstein is considerably more tentative in his conclusions on the usefulness of the concept than is Professor Alexander. Sunstein, *supra* note 2, at 1148, 1150. In any event, scholars in search of literary support for the theory of adaptive preferences would be better served by Robert Louis Stevenson than by Aesop. In Stevenson's short story *The Sire de Malétroit's Door* a young gallant, given two hours to choose between death and

omy of purchasers' preferences may therefore require legal interference with their nominal preferences."<sup>70</sup>

Alexander attacks the notice element of the equation by arguing that legal notice is not a sufficient basis for consent, presumably even if acceptance were free:

[T]he purchaser who acted without actual notice that the land she purchased was affected with an obligation may still be held to have had notice. The legal notion of constructive notice, provided by the land recording system, or by the surrounding circumstances, which may place on the purchaser a duty to inquire about the existence of restrictions creates this notice. If we base an inference of consent on this type of notice we greatly diminish the meaning, and the normative power, of consent.<sup>71</sup>

### 1. *Assessing Acceptance: Initial Observations*

Professors Frug and Alexander and Professor Epstein arrive at polar positions by their respective treatments of the elements on the left side of the consent formula. Frug and Alexander set unrealistic standards for acceptance. Epstein overestimates the power of legal notice to bring facts to the attention of the unit purchaser. Let us turn to the acceptance issue first.

For purposes of discussing acceptance, assume that the purchaser is fully aware of the terms of the deal and has agreed to purchase only after examining the documentation and reviewing all salient points with a lawyer. In other words, assume that the purchaser has good *product* knowledge. Professors Frug and Alexander seem to be saying that product knowledge is not sufficient for real acceptance, that real acceptance occurs only if the purchaser has perfect *market* knowledge and the opportunity to negotiate every term in the package.

As Professor Epstein observes, the Frug/Alexander standards of acceptance would make it impossible to classify as consensual a transaction in which shoelaces were "bundled" with a sale of shoes.<sup>72</sup> If consent is impossible when there is bundling or imperfect market knowledge, a shoe-and-lace purchase

marriage to a particular lady, manages to fall in love with her within the allotted time. See *THE COMPLETE SHORT STORIES OF ROBERT LOUIS STEVENSON* 231-54 (C. Neider ed. 1969). One might ask, however, whether his love would survive their first marital quarrel.

70. Alexander, *supra* note 4, at 894.

71. Alexander, *supra* note 4, at 892-93 (footnotes omitted). See also *id.* at 892-93, 901, nn.27, 28, 52 (referring to practical shortcomings in the notice system).

Why, in view of Professor Alexander's arguments, could *anyone* maintain that servitude regulation is consensual? Professor Alexander sets up his answer by observing that Dean Reichman favors the touch and concern test because he believes it maximizes freedom of choice while Professor Epstein opposes touch and concern because he believes it restricts freedom of choice. Alexander then concludes:

The choice between these two contradictory interpretations cannot be based on an abstract commitment to freedom of choice itself; both choices are simultaneously freedom-enhancing and coercive. Epstein and Reichman want to sanctify a subjective political choice—the allocation of power between generations of owners—by a linguistic gambit, namely, objectifying their political preference as choice maximizing and therefore more consistent with the general policy of servitude law.

*Id.* at 891-92.

Perhaps a more nearly correct answer is that Professor Epstein and Dean Reichman recognize that any rule adopted is likely to restrict choice, but differ as to which rule will restrict it less. The cause of their disagreement is not a carelessness for freedom; it arises from a lack of empirical research.

72. Epstein, *Covenants*, *supra* note 4, at 912.



would be characterized as coercive if the purchaser did not both (1) undertake an exhaustive survey of the world shoe-and-lace market and (2) dicker all terms (before the market changed) with each provider in the shoe-and-lace marketing chain—retailer, wholesaler, manufacturer, and raw material suppliers. Alexander seems to believe such a characterization (that is, “coercive”) would be plausible or at least “available” to describe a shoe-and-lace purchase, for choice and coercion “are rhetorics that . . . are both *always* available as interpretations of any given social experience.”<sup>73</sup> This reasoning, as Professor Epstein notes, proves too much: the term “choice” is *available* to describe torture in a Cuban prison cell on the basis that one “chose” that course by demonstrating against the Castro government while aware of the consequences. But to agree that such usages are “available” is not to concede that they are accurate or that they inform us of more than they conceal.

One can argue convincingly that in the absence of monopoly,<sup>74</sup> bundling and volitional purchase under conditions of imperfect market knowledge are in fact choice-maximizing rather than choice-restricting; that is, the free market offers bundled goods and purchasers buy them under conditions of imperfect knowledge and limited dickering when on the whole, the cost of offering independent goods and acquiring more perfect knowledge would reduce the range of people’s legally protected choices more than expand them. Obversely put, the proposition is that at our present state of technology, if the courts refused to enforce agreements that arose without unlimited dickering and perfect market knowledge, there would be very few legally enforceable choices made. This would be true because people could not find the time to arrive at very many enforceable agreements, because it would be exceedingly difficult to execute any such agreements,<sup>75</sup> and because the government could second-guess any agreements they managed to execute.

The last point—government second-guessing as inimical to meaningful consent—is worth emphasis because it is so often overlooked. When a purchaser has good product information, government oversight substitutes an official’s presumed knowledge of the needs of others for the purchaser’s knowledge of himself. It substitutes a decisionmaker with his own interests and distractions<sup>76</sup> (the politician, bureaucrat, or communally authorized neighborhood busybody<sup>77</sup>) for a purchaser with undivided loyalty to his own welfare. For reasons of both utility and personal freedom, therefore, the advocates of any particular plan for government review of independent decisionmaking bear the burden of demon-

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73. Alexander, *supra* note 4, at 884 (emphasis added).

74. The housing sales market is highly competitive, and there can be no supportable allegations of monopoly in the sale of POA units. See, e.g., *Levinson v. Maison Grande*, 517 F. Supp. 963 (S.D. Fla. 1981) (jury found defendants did not have sufficient power in the market to sustain plaintiff’s antitrust claim).

75. Because the facts of the market change constantly, consent would be valid only for an instant. A free exchange requires simultaneous choices by at least two people—quite difficult when consent for each is so fleeting.

76. See Epstein, *Covenants*, *supra* note 4, at 925. Professor Sunstein suggests that collective decisionmaking can, through the process of political discourse, intelligently separate supportable claims from claims based on “naked preferences.” Sunstein, *supra* note 2, at 1136. To those with political experience or historical training, this suggestion must seem overly sanguine.

77. See Ignatius, *China’s Golden Girls Monitor Neighbors*, *Wall St. J.*, Aug. 1, 1989, at A6, col. 4 (describing oversight functions of “neighborhood committees” in Communist China).

strating that in a given situation consumers are so apt to miscalculate and the costs of miscalculation are so disastrous and so nearly irreversible that the market cannot be relied upon to maximize choice. This demonstration ideally should be made on the basis of empirical experience, not on the basis of the politician's (or the scholar's) intuitive guess as to what might be good for other people. The historical demonstration has been sufficient, I think, to justify rules forbidding people from selling themselves into slavery or, what is much the same thing, prohibiting addiction to heroin.<sup>78</sup> There has been no demonstration, however, of market failure in the sale of shoes or in the purchase of units in an association subdivision.<sup>79</sup>

## 2. *Assessing Notice: Initial Observations*

A more serious challenge to the consent equation can be made by questioning the soundness of the element of *notice as an indicator of product knowledge*. Professor Epstein maintains that the recording system provides adequate notice to enable the consumer to exercise genuine choice in deciding whether to subject himself to a servitude scheme. This position, however, is open to challenge on several grounds. Professor Alexander suggests one basis for challenge: case law puts property purchasers on notice of many unrecorded circumstances. This is not merely the peripheral problem Epstein suggests it is.<sup>80</sup> Recorded standards for the exercise of discretion frequently are absent or are so broad

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78. The reference to heroin should not be taken as an endorsement of the common view that government is justified in imposing its "second order preferences" on those out of power. See, e.g., Sunstein, *supra* note 2. Advocates of that view, including Professor Sunstein, sometimes turn for support to the fable of Odysseus and the Sirens as exemplifying a proper use of government power.

Upon investigation, this reliance upon Homer turns out to be as misguided as the critical legal scholars' reliance upon Aesop. See *supra* note 69. The story of Odysseus and the Sirens is a tale of the *abuse* of power, not of its proper use. In the story, Odysseus decided to take advantage of his position as ship's captain to listen to the music of the Sirens—a pleasure that usually led to death on the shoals. Most of the costs of Odysseus' irresponsibility were passed on to his men: they were denied the opportunity to hear the song (or anything else), being required to keep their ears plugged with wax; they had to bind their captain to the mast (twice); and they did all the rowing while Odysseus did all the listening. THE ODYSSEY OF HOMER 185-87 (S. Butcher & A. Lang trans. 1950).

Professor Sunstein calls legislation of this type a "voluntary foreclosure of consumption choices" and cites mandatory seat belt laws as an example. Sunstein, *supra* note 2, at 1140. However, such laws are "voluntary" only to those in control of the government, and they are improper precisely for the reason Odysseus' action was improper: they impose the costs of some people's lack of control (irresponsibility) on innocent, responsible parties with different second order preferences. In the seat belt context, all or some of the cost of irresponsibility is shifted to responsible people who recognize that under some circumstances (when ministering to children, for example) the utility of removing a seat belt may exceed the utility of keeping it on.

Self-restraint laws are not open to the cost-shifting objection if they do not shift costs. Thus, the constitutional rights of individuals place the cost of potential government incontinence exactly where it belongs—on the government. Cf. Sunstein, *supra* note 2, at 1141. Statutes forbidding heroin use cause no loss (other than administrative cost) to responsible people, because unlike alcohol, tobacco, or nonuse of seatbelts, heroin cannot be consumed responsibly. When, however, administrative cost exceeds utility gain, a society will wish to re-examine even statutes forbidding heroin.

79. This statement presumes product knowledge even in the absence of market knowledge. Recall that in considering the acceptance element of the "acceptance + notice = consent" equation, we are assuming the purchaser has knowledge of all aspects of the deal.

80. Epstein, *Covenants*, *supra* note 4, at 911. For another view of the problem of notice, see Winokur, *supra* note 4, at 59-62.

that a court must refer to the condition of the subdivision, physical<sup>81</sup> or otherwise,<sup>82</sup> in order to give them content. Often the inquiry must be into the condition of the subdivision at some time prior to the time of trial.<sup>83</sup>

In many parts of the country, the recording system is so poorly organized, so overloaded,<sup>84</sup> and so incompetently operated as to be of limited utility. The courts often refuse to bind litigants to the "notice" it affords.<sup>85</sup> Moreover, some of the classic cases on the subject of inquiry notice arose because of defects in the recording system.<sup>86</sup> In recent decades, private enterprise (specifically abstractors and title insurance companies) has come to the rescue of the government recording system, just as private couriers have rescued the United States Postal Service. Part of the value of private title examiners is that they offer expert navigation through the shoals of the county records. Increasingly, however, title examiners disregard the county records except as a source of new filings, and instead operate their own computer-operated databases.<sup>87</sup>

The clumsiness of the recording system is such that if the typical unit buyer is to examine the servitude scheme, he probably will have to acquire the operative documents from the developer, the association, an abstractor, a title company, a lawyer, or a real estate broker. As a rule, one of these individuals or entities does provide the purchaser with the documents, although often not as promptly as would be ideal.<sup>88</sup>

In the ordinary use of the term, one does not "assent" to a state of affairs merely because it was possible to learn of that state of affairs. In ordinary usage, one "assents" to a situation when one affirmatively accepts it while know-

81. *Rhue v. Cheyenne Homes*, 168 Colo. 6, 449 P.2d 361 (1969); *Town & Country Estates Ass'n v. Slater*, 227 Mont. 489, 740 P.2d 668 (1987).

82. *Lyons v. King*, 397 So. 2d 964 (Fla. Dist. Ct. App. 1981) (residential nature of subdivision guided discretion on approval or disapproval of purchasers).

83. See, e.g., *Ottawa Shores Home Owners' Ass'n v. Lechlak*, 344 Mich. 366, 73 N.W.2d 840 (1955); *Davis v. Huey*, 620 S.W.2d 561 (Tex. 1981) (state of development when owner purchased).

84. For a comment on the phenomenon of overloading the recording system, see Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 585-90 (1988).

85. In Montana, for example, the recording system in many counties is poorly organized and inaccessible. Land transactions in Montana usually are relatively informal. Perhaps because of the interplay of these factors, the state supreme court has *never* enforced a covenant against a party without reciting some reason why the owner should have known of the covenant beyond the fact that it was recorded. Natelson, *Running with the Land in Montana*, 51 MONT. L. REV. 17, 72 (1990). See also *Goeres v. Lindsey's, Inc.*, 190 Mont. 172, 619 P.2d 1194 (1980) (refusing to enforce reciprocal negative easements based on recorded deed outside lot owner's chain of title in absence of finding that lot owner had actual knowledge of restrictions prior to purchase).

The foregoing applies to Montana alone, but judicial reluctance to bind people to the purely constructive notice of the recording system cuts across state lines. By way of illustration, in oil and gas law the scope of the covenant of general warranty is often limited by excepted interests of which the grantee has actual notice, but not by excepted interests of which the grantee has record notice only. Compare *Gilbertson v. Charlson*, 301 N.W.2d 144 (N.D. 1981) (actual notice) and *Hartman v. Potter*, 596 P.2d 653 (Utah 1979) (actual knowledge) with *Sibert v. Kubas*, 357 N.W.2d 495 (N.D. 1984) (record notice only). Cf. E. KUNTZ, J. LOWE, O. ANDERSON & E. SMITH, *CASES AND MATERIALS ON OIL AND GAS LAW* 579 (1986). See also the cases set forth *infra* notes 106-11, in none of which the court relied exclusively upon the recording system to establish notice.

86. See, e.g., *Sanborn v. McLean*, 233 Mich. 227, 206 N.W. 496 (1925), which Alexander cites. In *Sanborn* the court enforced restrictions that did not appear in the lot owner's chain of title, but that would have so appeared in a rational system of registration.

87. These are called title plants. See *Johnstone, Land Transfers: Process and Processors*, 22 VAL. U.L. REV. 493, 507 (1988).

88. R. NATELSON, *supra* note 6, at 371.

ing of it or, although ignorant of the details, makes a conscious decision to proceed without information that one knows to be available at little effort or cost—that is, information of which one has *actual*, as opposed to merely legal, notice. Thus, the average person might say that Deborah, a homeowner, accepted the terms of a “simple” landscaping agreement if she signed the contract without bothering to read it, for if the contract is “simple,” she knows that full product information is available at little effort or cost. However, “little effort or cost” is a relative term; it depends upon the magnitude of the interests at stake. If the landscaping project involved the replacement of two small bushes, most people probably would conclude that it would involve little effort or cost for Deborah to read a seventy-five-word contract. On the other hand, if the project involved extensive landscaping for a large apartment complex, one might reasonably expect Deborah to read a 500-word document. One might say that even if she did not read the document, she had actual notice of its contents.

The question arises as to how one treats a contract when product information is unknown and is available only at great effort or cost. Suppose that Deborah was unschooled in landscaping terminology and that the bush-replacement contract was contained in a 2000-word form supplied by the landscaping company. Suppose further that it included significant but innocent-appearing provisions with specialized meanings whose content could be known only by reference to a manual of industry standards.<sup>89</sup> Deborah probably would be on actual notice of some, but not all, terms of the contract. In this event, resort may be had to Llewellyn’s standard for interpreting acceptance of a boilerplate form: assent to dickered terms and to the “broad type of the transaction” and “a blanket assent (not a specific assent) to any *not unreasonable* or indecent terms the seller may have on his form, which do not alter or eviscerate the reasonable meaning of the dickered terms.”<sup>90</sup> The economic justification for this standard is that in the usual boilerplate transaction it is not efficient for the recipient of the form to examine terms in the form that do not affect the core of the transaction. Reasonableness review provides necessary content to Llewellyn’s “blanket assent.”<sup>91</sup>

The formidable appearance and technical language of the operative documents of many POAs suggest resort to Llewellyn’s boilerplate standards, but the suggestion is misleading. However dense the operative documents may be, purchase of a subdivision unit is not the normal boilerplate transaction. In the normal boilerplate transaction the price is low enough that examination of the boilerplate would be needlessly time-consuming and employment of legal counsel would not be cost-effective. In the purchase of real estate, however, the sales

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89. Cf. U.C.C. § 1-205(3) (Usage of trade qualifies or supplements other terms only if both parties are engaged in trade or “of which they are or should be aware.”).

90. K. LLEWELLYN, *supra* note 3, at 370 (emphasis added).

91. Cf. American Law Institute & National Conference of Commissioners on Uniform State Laws, *Report and Second Draft of the Revised Uniform Sales Act* in 1 UNIFORM COMMERCIAL CODE: DRAFTS 304 (E. Kelly ed. 1984) (“[T]he position of the Draft is that the reasonableness of assuming *both* parties to have chosen and agreed to incorporate such a set of clauses, in silence and without dickering, depends upon whether the series of clauses presents the kind of balanced background which parties can fairly, or indeed accurately, be thought to incorporate by silence.”).

price is significant enough to render examination of the documents and employment of legal counsel highly cost-effective.<sup>92</sup> Moreover, in the usual form transaction only one party, the drafter, is relying on the boilerplate. In sales of units in association subdivisions many other unit purchasers are relying upon it.<sup>93</sup>

We are now faced with four observations on notice that imply varying results. The inadequacies of the recording system are such that it does not provide purchasers with actual notice of the terms of subdivision documents. The fact that those purchasers often receive the materials too late to examine them also suggests absence of actual notice. On the other hand, the common practice of title companies, developers, and brokers of giving the documents to prospective purchasers suggests that many purchasers have the opportunity to examine the documents before they agree to buy, and the nature and importance of the transaction imply that purchasers are under a far heavier burden to examine those documents and therefore are more readily chargeable with actual notice than in the usual boilerplate contract.

Under these circumstances, whether purchasers have actual notice of the terms of subdivision documents is not a question that can be answered a priori or on the basis of anecdotal evidence;<sup>94</sup> it needs to be answered empirically.

### 3. *Notice and Consent: The Empirical Evidence and Judicial Response*

In the POA context, a purchaser needs actual notice of certain facts in order to give effective consent to the substance and procedures of existing association regulations. These facts include the existence of a scheme of land governance, the presence of an association, the content of the regulations as of the date of purchase, and the general scope of the association's power to alter the regulatory scheme in the future. We can say that a purchaser accepting a deed with such product information really did consent to the substance of the transaction. Whether acceptance takes place in conditions of actual notice, therefore resulting in effective consent, may vary from time to time and from place to place.

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92. The cost of legal counsel is likely to be minimal in comparison to the cost of the real estate being purchased. In southeastern New York State, for example, the prevailing fees for representation in a residential real estate purchase from contract through closing are less than one percent of the unit sales price.

93. See *Riley v. Stoves*, 22 Ariz. App. 223, 526 P.2d 747 (1974); *Hidden Harbour Estates v. Basso*, 393 So. 2d 637 (Fla. Dist. Ct. App. 1981).

When the prospective buyer of a POA unit has an opportunity both to examine the documents (such as servitudes and the buy-sell agreement) governing the transaction and to employ legal counsel, the buyer is well positioned to avoid future dissatisfaction with the deal. The buyer potentially dissatisfied with the servitudes, upon which other purchasers rely, is the least cost avoider because he can purchase elsewhere. The buyer dissatisfied with the buy-sell agreement is the least cost avoider because he may purchase elsewhere or renegotiate. Despite the belief of some commentators that a developer's form contracts are set in stone, my own experience as a practitioner indicates otherwise. For a case in which buyers renegotiated a developer's terms, see *Wechsler v. Goldman*, 214 So. 2d 741 (Fla. Dist. Ct. App. 1968).

94. Anecdotal evidence can be found to support both sides of the argument over whether prospective purchasers have actual notice. Professor Winokur collects evidence on both sides, although predominately against notice. Winokur, *supra* note 4, at 59 n.246. In my own practice experience, spanning a decade of representing middle and working class people in real estate transactions and in postclosing disputes, I encountered only one client who had been unaware of the existence of the association or the general regulatory scheme prior to purchase, and that was a de minimis association.

Dr. Vivian Walker conducted an empirical survey of condominium owners in Chicago during 1979 and 1980. In addition to a wider sampling, she conducted two-hour personal interviews with forty-three condominium owners.<sup>95</sup> She reports that although most people obtained the condominium documents before purchase,<sup>96</sup> few read them or were fully aware of their significance.<sup>97</sup> Her opinion is that meaningful knowledge of on-going condominium operations would have been difficult to obtain in Chicago at that time because of the novelty of the condominium concept and the overheated nature of the market. She questions the effectiveness of consent under such circumstances.<sup>98</sup>

On the other hand, a more recent and far larger survey suggests that at other places and times there can be effective consent. In 1987 Professors Steven Williamson and Ronald Adams surveyed a random sample of 767 Florida condominium owners.<sup>99</sup> Several of the survey questions were designed to elicit reasons for the owners' purchases. Over ninety-two percent of the respondents considered the existence of the regulatory scheme to be "very important" or "important" to their determination to purchase, and nearly eighty-five percent considered participation in an association to have been "very important" or "important" to that decision.<sup>100</sup> Of course, those results would not have been possible unless the purchasers had known of the existence of the scheme and of the association prior to purchase. Such widespread knowledge is not surprising, given the existence of a Florida disclosure law mandating that purchasers receive condominium documentation prior to purchase,<sup>101</sup> the growth of consumer awareness since the Walker survey, and the widespread practice of sales agents of outlining the major existing regulations to prospective purchasers ("no children, no pets over 20 pounds") in order to avoid later demands for rescission. The conclusion that Florida purchasers had advance knowledge of what they were purchasing receives inferential support from the extremely high levels of owner satisfaction found in the study.<sup>102</sup>

95. The wider survey was of 599 owners in five different cities, but the results reported here do not rest on the wider survey. For her methodology, see V. Walker, *supra* note 12, at iii, 10.

96. As required by ILL. ANN. STAT., ch. 30, para. 322 (Smith-Hurd Supp. 1989).

97. Telephone Interview with Vivian G. Walker, Ph.D., Instructor, Kellogg Graduate School of Management, Northwestern University and past president of the Community Associations Institute Research Foundation (Jul. 14, 1989) [hereinafter Telephone Interview].

98. *Id.*

99. FLORIDA STUDY, *supra* note 12, at 43.

100. Owners were asked whether "rules and regulations which affect my lifestyle" were "very important," "important," "unimportant," or "totally unimportant" to their purchase decision. The respective percentage responses from the entire sample were 34.0, 58.6, 6.0, and 1.4. Owners were asked whether "ability to exert control over expenses and management through a democratic owner's association" was "very important," "important," "unimportant," or "totally unimportant" to their purchase decision. The respective percentage responses from the entire sample were 25.4, 59.2, 13.4, and 2.0. FLORIDA STUDY, *supra* note 12, at 56.

101. See, e.g., FLA. STAT. ANN. § 718.503(2) (West 1988) (requiring seller to provide buyer with copies of governing documents).

102. 81.2% of respondents stated that they would purchase the same condominium unit if given the choice to do so again. FLORIDA STUDY, *supra* note 12, at 69.

These findings are consistent with those of other surveys. See, e.g., R. Burby, *supra* note 12, at 13-15 (satisfaction level with recreational facilities, maintenance of common properties, social activities and programs, architectural control, representation of residents' views to local government, and representation of residents' views to developer all well in excess of 80%). The latter study offers an interesting commentary on the value of federalism.

The Florida findings do not demonstrate that purchasers knew of all matters important to consent. They might well have been ignorant of existing regulations unlikely to be emphasized by sales personnel or of the association's power to alter existing regulations. Nevertheless, based upon what the Florida purchasers already knew, we may conclude that they consented to the remaining regulations and to the association's alteration power because they had actual notice of them: with actual knowledge of the broad terms of the governing documents, with the documents themselves in hand, and with legal counsel available and cost-effective to use, ignorance of additional information about the servitude scheme must have been the result of a conscious choice not to obtain such information, even though the purchasers were aware that it was available at little effort or cost.<sup>103</sup>

It may be argued that a purchaser's decision to proceed without easily and inexpensively obtainable product information is an irrational choice, and thus not a choice at all. But there is no normative or empirical standard that holds that all choice must be rational—even if uniform rationality would make economic models more accurate. Further, a purchaser may have excellent reasons for deliberately deciding to proceed with only imperfect product knowledge. It may be necessary to act quickly in order to lock in a favorable price in a rapidly appreciating real estate market. The purchaser may have a personal need for quick action—establishing a tax deduction in the current fiscal year, for example, obtaining alternate housing before a current lease expires, or acquiring title for a projected resale.<sup>104</sup>

Consistently with the findings of the Williamson survey, the Florida courts have determined that there usually is effective consent to decisions *predating* a unit owner's purchase and that such decisions are not subject to reasonableness review on a challenge by that owner. In the language of the leading Florida case, pre-existing regulations

are clothed with a very strong presumption of validity which arises from the fact that each individual unit owner purchases his unit knowing of and accepting the restrictions to be imposed. . . . [Such a regulation] may have a certain degree of unreasonableness to it, and yet withstand attack in the courts.<sup>105</sup>

The conclusion of the court that "each . . . owner purchases his unit knowing of . . . the restrictions" derives force from the fact patterns of the applicable cases. In virtually all of the "consent" cases there is evidence that the dissatisfied unit owner knew of a pre-existing restriction or exercised a conscious determination not to learn. Thus, the unit owner may be a subdivision developer

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It found that resident satisfaction tends to be higher in decentralized, "federalized" POAs than in centralized POAs, despite the fact that centralized POAs provide more services more efficiently. *Id.*

103. See *supra* text following note 88.

104. Judge Adkins discusses the investment-driven motives of many or most Florida condominium buyers in *Conklin v. Hurley*, 428 So. 2d 654, 660 (Fla. 1983) (Adkins, J., dissenting). Cf. *FLORIDA STUDY*, *supra* note 12, at 56 (74% of condominium owners purchased in part for investment opportunity).

105. *Hidden Harbour Estates v. Basso*, 393 So. 2d 637, 639-40 (Fla. Dist. Ct. App. 1981). Those words referred to a condominium declaration, but the principle has since been extended to other rules in effect when a unit owner purchased. *Constellation Condominium Ass'n v. Harrington*, 467 So. 2d 378 (Fla. Dist. Ct. App. 1985).

whose own lawyer drafted a restriction,<sup>106</sup> a purchaser who agreed to a regulation in writing,<sup>107</sup> an experienced real estate dealer who admitted knowing of a restriction,<sup>108</sup> a landlord or tenant who deliberately crossed out a "no children" provision in a POA's standard lease,<sup>109</sup> a purchaser in an all-adult subdivision that was widely promoted as such,<sup>110</sup> or a pet owner who admitted knowing at the time of purchase that she would not be able to replace her dog.<sup>111</sup>

Besides the obvious normative basis for holding one to the terms one has agreed to, the result in these Florida cases is justifiable on efficiency grounds. As between the unit purchaser potentially dissatisfied with the terms of the governing documents and those other purchasers who potentially rely upon them, the potentially dissatisfied purchaser is the least cost avoider. He can avoid the cost by buying elsewhere or, if he has already purchased, by selling.

The courts of several other states follow the Florida rule and grant a pre-existing POA decision a strong presumption of validity against a challenge from a unit owner who purchased a unit after the association had promulgated its decision.<sup>112</sup> The courts of those states are justified in doing so if the relevant circumstances are similar to those in the Florida cases. This may or may not be true. There are local and temporal differences in the efficacy of recording systems, in the content and effectiveness of disclosure statutes, in relevant customs, and in the nature of the market. All of these factors may affect the determination of whether the potentially dissatisfied purchaser really did consent to the regulations and whether that purchaser is the least cost avoider. The discrepancy between the Walker and the Williamson findings illustrates this point.

In each state, therefore, the judiciary must determine the extent to which POA unit purchasers are likely to have given effective consent—that is, whether they know of pre-existing regulations or remain in ignorance only as a result of a conscious decision not to acquire information available at little cost or effort.<sup>113</sup> Moreover, in some cases a court will have to consider the circumstances

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106. *LeFebvre v. Osterdorf*, 87 Wis. 2d 525, 275 N.W.2d 154 (1979).

107. *Coquina Club, Inc. v. Mantz*, 342 So. 2d 112 (Fla. Dist. Ct. App. 1977).

108. *Constellation Condominium Ass'n v. Harrington*, 467 So. 2d 378 (Fla. Dist. Ct. App. 1985).

109. *Preston Tower Condominium Ass'n v. S.B. Realty*, 685 S.W.2d 98 (Tex. Ct. App. 1985).

110. *Riley v. Stoves*, 22 Ariz. App. 223, 526 P.2d 747 (1974).

111. *Wilshire Condominium Ass'n v. Kohlbrand*, 368 So. 2d 629 (Fla. Dist. Ct. App. 1979).

112. *Preston Tower Condominium Ass'n v. S.B. Realty*, 685 S.W.2d 98 (Tex. Ct. App. 1985) (bylaws); *Unit Owners Ass'n of Buildamerica-1 v. Gillman*, 223 Va. 752, 292 S.E.2d 378 (1982) (house rules).

113. For example, the Massachusetts condominium law provides that the bylaws should contain any restrictions on the use of units and that the bylaws must be recorded with the master deed. In *Johnson v. Keith*, 368 Mass. 316, 331 N.E.2d 879 (1975), a unit pet regulation was imposed by a house rule rather than a bylaw. The unit owner knew of the house rule prior to purchase, but because of the statutory scheme, other buyers might not think to look beyond the bylaws for unit use restrictions.

The Supreme Judicial Court struck down the house rule, holding that it should have been written in the bylaws. *Id.* at 320, 331 N.E.2d at 882. This was not a necessary construction of the statute; the statute did not forbid imposition of additional unit restrictions by house rule. However, the court's conclusion was correct on the following grounds: (1) Because of the legally sanctioned custom of inserting unit use restrictions in the bylaws, Massachusetts condominium buyers were likely to overlook restrictions located in the house rules; (2) house rules, if predating the owner's purchase, were subject to reasonableness review rather than the presumption of validity granted restrictions to which an owner consents; and (3) the particular rule (a flat ban on pets) was unreasonable because it imposed disproportionate loss, without compensation, on a particular class of members (pet owners). See *infra* Part V.



of the particular POA. If, for example, the complaining unit owner did not know of a regulation prior to purchase, and it was not readily available to prospective purchasers, that regulation should not be granted a strong presumption of validity. It should be subject to reasonableness review.

#### IV. REGULATION WITHOUT CONSENT

##### A. *The Efficiency Principle*

All courts apply a reasonableness standard to POA decisions to which the complaining unit owners have not effectively consented—those adopted after the unit owners purchased,<sup>114</sup> memorialized in a place other than that dictated by law or custom,<sup>115</sup> or based on management policy derived from pre-existing regulations but not clearly inferable from those regulations.<sup>116</sup> Although the Florida courts recently have assumed the lead in applying the reasonableness standard to POAs, reasonableness review of POA decisions was first applied in New York.

Property lawyers best remember Judge Irving Lehman of the New York Court of Appeals for his opinion in *Neponsit Property Owners' Association v. Emigrant Industrial Savings Bank*,<sup>117</sup> but his ruling in *Drabinsky v. Sea Gate Association*,<sup>118</sup> issued thirteen years earlier, has proven equally important. The facts of *Drabinsky* were that in 1897 a developer owning land near Coney Island in Brooklyn filed a subdivision plat and proceeded to construct a private

A court's judgment may also be affected by the local value hierarchy, as the history of interpretation of the "Uniform" Commercial Code demonstrates. *Compare* *Sun 'N Sand, Inc. v. United Cal. Bank*, 21 Cal.3d 671, 148 Cal. Rptr. 329, 582 P.2d 920 (1978) (recognizing negligence cause of action outside Code by free construction of Code; holding bank to high standard by determining that check payable to bank not equivalent of bearer paper) *with* *Indyk v. Habib Bank Ltd.*, 694 F.2d 54 (2d Cir. 1982) (applying New York policies encouraging free flow of commercial paper by strict Code construction); *Bankers Trust Co. v. Litton Systems*, 599 F.2d 488 (2d Cir. 1979) (same); *and* *J. Gordon Neely Enters. v. American Nat'l Bank of Huntsville*, 403 So. 2d 887 (Ala. 1981) (holding bank to lower standard by determining that check payable to bank is equivalent of bearer paper). *Compare also* the differing judicial attitudes in widely separated states in two U.C.C. faithless employee cases: *J. Gordon Neely and Gresham State Bank v. O & K Constr. Co.*, 231 Or. 106, 370 P.2d 726, *opinion clarified on denial of reh'g*, 231 Or. 129, 372 P.2d 187 (1962). In each state egalitarianism, flexibility, certainty, alienability, and other values rest on different levels of the value hierarchy.

114. *Rywalt v. Writer Corp.*, 34 Colo. App. 334, 526 P.2d 316 (1974); *Juno By the Sea N. Condominium Ass'n v. Manfredonia*, 397 So. 2d 297 (Fla. Dist. Ct. App. 1981), *review denied*, 402 So. 2d 611 (Fla. 1981); *Hidden Harbour Estates, Inc. v. Basso*, 393 So. 2d 637 (Fla. Dist. Ct. App. 1981); *Winston Towers 200 Ass'n v. Saverio*, 360 So. 2d 470 (Fla. Dist. Ct. App. 1978); *Monell v. Golfview Road Ass'n*, 359 So. 2d 2 (Fla. Dist. Ct. App. 1978); *Seagate Condominium Ass'n v. Duffy*, 330 So. 2d 484 (Fla. Dist. Ct. App. 1976); *Hidden Harbour Estates v. Norman*, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975); *Dulaney Towers Maintenance Corp. v. O'Brey*, 46 Md. App. 464, 418 A.2d 1233 (1980); *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981); *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977).

115. *Johnson v. Keith*, 368 Mass. 316, 331 N.E.2d 879 (1975). *See supra* note 113.

116. *Chateau Village N. Condominium Ass'n v. Jordan*, 643 P.2d 791 (Colo. App. 1982); *Lyons v. King*, 397 So. 2d 964 (Fla. Dist. Ct. App. 1981).

117. 278 N.Y. 248, 15 N.E.2d 793 (1938).

118. 239 N.Y. 321, 146 N.E. 614 (1925). Judge Lehman composed another important POA case, now also neglected: *In re Public Beach*, 269 N.Y. 64, 199 N.E. 5 (1935), was a condemnation proceeding in which the court of appeals permitted the Neponsit POA to represent its unit owners in their claims for lost easement rights in an association-owned common beach. The holding in *Public Beach* was critical to the "vertical privity" portion of the later *Neponsit* case.

residential park. The Sea Gate subdivision included, among other amenities, an ocean beach, a bathhouse, and a stable. In order to prevent this "healthful residential colony" from being overrun by the "excursionists" who frequented Coney Island, the developer provided a single entrance to Sea Gate, monitored by a guard and (as the subdivision's name might imply) a gate. From the entrance way, private streets branched out to serve the various lots.<sup>119</sup>

In 1899 the developer established the Sea Gate Association, a POA in which lot owner membership was voluntary. The following year, the developer conveyed a lot to Jacob Mack, and in 1901 it delegated to the association ownership of and responsibility for the entrance way, the common streets, and the common amenities.<sup>120</sup>

In 1919 the association adopted a series of rules that regulated admission to the private streets, although there was no recorded document expressly granting the POA the right to do so. The following year, Wolf Drabinsky purchased the Mack lot from Mack's successor-in-interest. Drabinsky declined to join the association and sued to enjoin enforcement of the entrance regulations.<sup>121</sup>

Speaking for a unanimous court, Judge Lehman held that the association had the right to issue regulations governing admission to the subdivision, provided such regulations were "reasonable and adapted solely to [the subdivision's] purpose and are equally applied."<sup>122</sup> In doctrinal terms, Judge Lehman ruled that when the developer granted an easement to Mack, the developer impliedly reserved from that grant the power to issue reasonable rules for the use of the easement; this reservation passed to the POA in 1901, along with other common area ownership and responsibility. Drabinsky purchased Mack's easement subject to that reservation.

Essentially, Judge Lehman held that a rule was reasonable if it was within the scope of what Jacob Mack might have foreseen. What Mack might have foreseen could be determined from examining the circumstances as they existed in 1900 and ascertaining what he must have known about other lot purchasers' expectations of what the subdivision would be.<sup>123</sup> The court concluded that Mack could expect that the association would act in a way appropriate to preserve the character of Sea Gate, for only the association could protect Sea Gate without incurring prohibitive transaction costs.<sup>124</sup> The court added that rules

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119. 239 N.Y. at 324-25, 146 N.E. at 614-15.

120. *Id.*

121. *Id.*

122. *Id.* at 329, 146 N.E. at 617.

123. All the purchasers of lots in Sea Gate received the same easement. If one person is permitted to use the streets in such a manner as would tend to destroy its character as a street in a private residential colony, then all the others who purchased upon the understanding that the use of the street might be appropriately restricted would lose some of the benefit of their purchase.

*Id.* at 327-28, 146 N.E. at 616.

124. Of course, in the absence of association rulemaking power the lot owners could regulate by unanimous consent. That, however, would be a clumsy procedure and an invitation to holdouts. Only the association, noted Judge Lehman, "is in a position to formulate general rules which will preserve the rights of all parties and restrict the use of the street to the purpose for which it was granted." *Id.* at 328, 146 N.E. at 616.

that might protect the Sea Gate community by restricting individual prerogatives were within the scope of foreseeability.<sup>125</sup>

Despite doctrinal differences between *Drabinsky* and more modern cases,<sup>126</sup> many of the latter also express the view that the purchaser who buys with notice of a discretionary power accepts the risk that the power may be used in a way that benefits the commonality but harms the individual.<sup>127</sup> Under this theory, the consent to the association's rulemaking power implies consent to the substance of future decisionmaking, so long as future decisions serve overall efficiency purposes and association officials do not violate their fiduciary obligations.<sup>128</sup>

### B. *Limits of the Efficiency Principle*

Yet, risk-acceptance analysis and the efficiency principle do not fully explain many other reasonableness review cases. Risk-acceptance and efficiency do not even fully explain *Drabinsky*. After sustaining the reasonableness of one rule, the *Drabinsky* court discussed another, one restricting a lot owner to ten guests per day. Although the court could have employed risk-acceptance and efficiency analysis either to sustain or to invalidate the rule, the court instead relied upon the rights of property:

The right of the plaintiff to use his own property in any lawful manner he sees fit except as restricted by the deed of conveyance to him, cannot be disputed, yet by this rule the defendant [POA], as the owner of the bed of the street, assumes to limit the number of guests the plaintiff may receive on any one day. . . . The plaintiff has the right to decide for himself how many persons he will receive in his home. . . . [This rule], if enforced, would infringe upon his property rights and give the owner of the bed of the street the right to dictate the use to which plaintiff may put his own property.<sup>129</sup>

The foregoing language strongly suggests that the mere fact that a POA resolution is efficient and foreseeable does not mean that a court will necessarily

125. The *Sea Gate* court spoke of "the formulation of regulations . . . for the benefit of all property owners" and "notice . . . that such restriction . . . would be imposed." *Id.* at 328, 329, 146 N.E. at 616, 617.

126. *Sea Gate* was a property conveyancing case, as are some of the modern decisions. See, e.g., *Howorka v. Harbor Island Owners' Ass'n*, 292 S.C. 381, 356 S.E.2d 433 (1987) (developer conveyed easement subject to POA's pre-existing rulemaking power). Many other modern cases, however, rely upon contract or statutory bases.

127. *Kroop v. Caravelle Condominium, Inc.*, 323 So. 2d 307, 309 (Fla. Dist. Ct. App. 1975) ("Plaintiff acquired title to her condominium unit with knowledge that the Declaration of Condominium might thereafter be lawfully amended"); *Warren v. Del Pizzo*, 46 Or. App. 153, 611 P.2d 309, *modified on other grounds*, 48 Or. App. 237, 616 P.2d 1186 (1980) (similar language); *Cohen v. Kite Hill Community Ass'n*, 142 Cal. App. 3d 642, 652, 191 Cal. Rptr. 209, 215 (1983) (holding that a POA acting for the group is incapable of violating a duty to an individual); *Hidden Harbour Estates v. Norman*, 309 So. 2d 180, 182 (Fla. Dist. Ct. App. 1975) (each unit owner must give up freedom of choice and property rights for benefit of majority); *Ryan v. Baptiste*, 565 S.W.2d 196, 198 (Mo. Ct. App. 1978) ("balancing of rights of the individual unit owner and of the entire residential community"; "individual owners come together and agree to subordinate some of their traditional ownership rights and privileges when they choose this type of ownership experience"). See *O'Buck v. Cottonwood Village Condominium Ass'n*, 750 P.2d 813 (Alaska 1988); *Laguna Royale Owners Ass'n v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981).

128. On those obligations, see R. NATELSON, *supra* note 6, at 446-84.

129. 239 N.Y. at 330-31, 146 N.E. at 617.

permit the resolution to stand. It will be invalidated if it invades a unit owner's "property" rights. Similar sentiments pervade modern cases on the subject.<sup>130</sup>

The fact that the courts find it necessary to protect the unit owner from the consequences of his "consent"<sup>131</sup> suggests that the courts are uncomfortable with consent theory as a basis for the decisionmaking power. And well they should be. Unit owners do not give advance consent to the *substance* of future POA decisions because there cannot be advance knowledge of them. Such decisions, therefore, are more nearly coercive than consensual.<sup>132</sup> The courts review POA decisions on a reasonableness standard not because that standard defines the scope of consent, but because, as we shall see, the standard serves as a plausible *substitute* for consent.

### C. *The Unanimity and Compensation Principles*

Courts adjusting burdens among parties who, because of high transaction costs, cannot negotiate their own adjustments, often attempt to approximate the deal the parties might have made for themselves if transaction costs had been lower.<sup>133</sup> In the POA context, agreement between the developer and unit pur-

130. See *Constellation Condominium Ass'n v. Harrington*, 467 So. 2d 378 (Fla. Dist. Ct. App. 1985) (oppression not permitted); *Winston Towers 200 Ass'n v. Saverio*, 360 So.2d 470 (Fla. Dist. Ct. App. 1978) ("retroactive" regulation voided); *Monell v. Golfview Road Ass'n*, 359 So. 2d 2, 4 (Fla. Dist. Ct. App. 1978) (refusing to balance conveniences where unit owner's "easement . . . was substantially diminished"); *River Terrace Condominium Ass'n v. Lewis*, 33 Ohio App. 3d 52, 514 N.E.2d 732 (1986) (discrimination not permitted). For comparable language, see *Casita de Castilian, Inc. v. Kamrath*, 129 Ariz. 146, 629 P.2d 562 (Ct. App. 1981); *Thanasoulis v. Winston Towers 200 Ass'n, Inc.*, 110 N.J. 650, 542 A.2d 900 (1988); *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981); *Unit Owners Ass'n of Buildamerica-1 v. Gillman*, 223 Va. 752, 292 S.E.2d 378 (1982).

Cf. *Makeever v. Lyle*, 125 Ariz. 384, 609 P.2d 1084 (Ct. App. 1980); *Lion Square Phase II and III Condominium Ass'n v. Hask*, 700 P.2d 932 (Colo. App. 1985); *Westbridge Condominium Ass'n v. Lawrence*, 554 A.2d 1163 (D.C. App. 1989); *Thiess v. Island House Ass'n*, 311 So. 2d 142 (Fla. Dist. Ct. App. 1975); *Cohn v. Brodsky*, 138 Misc. 2d 1020, 526 N.Y.S.2d 345 (City Ct. 1988); *Preston Tower Condominium Ass'n v. S.B. Realty*, 685 S.W.2d 98 (Tex. Ct. App. 1985) (each invalidating association attempts to alter the initial allocation of common elements or assessments).

131. A notable exception is Oregon. See *Warren v. Del Pizzo*, 46 Or. App. 153, 611 P.2d 309, *modified on other grounds*, 48 Or. App. 237, 616 P.2d 1186 (1980) (refusing to limit amendments to the declaration by reasonableness review).

132. I do not mean to imply that this coercive aspect of POA governance renders POAs like government or that it justifies application of public law standards to POAs. Consent-coercion is a continuum, not a duality, and POAs stand considerably closer on the continuum to most other private organizations than to government.

An important distinction between private coercion and public coercion is that the former usually is easier to avoid and easier to escape. As noted earlier, *supra* note 37, most POAs are of very small extent, and their jurisdiction is accordingly easy to avoid and moderately easy to escape.

Another measure of coercion is the degree of centralization of different functions. Most governments control far more functions than POAs. See *supra* note 38 and accompanying text.

Still another measure of coercion is the consequences of disobedience. On the relevant distinctions between POAs and government, see *supra* note 40.

For a public law theory that when individuals delegate their power to the sovereign, they pre-emptively "consent" to *whatever* the sovereign might do, see T. HOBBS, *LEVIATHAN* 131-32, 136-37, 187 (E. Oakshott ed. 1962). This theory still has some force in the public law, despite the influence of Locke, see *infra* note 147, but is widely rejected in private law. *Infra* Part IV. D.

133. See Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972). This is, of course, the underlying purpose of reasonableness review in the boilerplate deal.

Over the past decade, commentators writing in several discrete substantive areas have noted the courts' tendency to impose "hypothetical bargains" where actual consent is impractical or otherwise absent. See, e.g.,

chasers at the time of contracting as to the precise way of handling future circumstances is impossible or undesirable, not merely because of transaction costs, but also because future circumstances are unknown at the time of purchase.<sup>134</sup> The judicial response, nevertheless, is the same: courts seek to ensure that association decisions binding on unit owners and arrived at after those owners have purchased their units do not disadvantage those owners in any significant way.

Thus, the lesson of *Drabinsky* and similar cases is that in judicially reviewing a POA decision, the court's inquiry is not into what the unit purchasers might have foreseen the association as doing, but what *those purchasers themselves* might have done had they foreseen future circumstances. As an organization with jurisdiction over all unit owners, the association might be expected to act on purely majoritarian grounds, for instance, by adopting resolutions that benefit the majority more than they harm that majority. Alternatively, an association might decide issues based on the Kaldor-Hicks criterion of efficiency, without otherwise attending to minority losses.<sup>135</sup> Under either formulation, the minority of unit owners may be worse off than before adoption of the resolution.

Contracting parties act on the basis not of majority rule, but of unanimity: if a person does not think a contract will benefit him, that person will not be a party to the contract. When a court assesses the reasonableness of a new POA resolution, the court adopts the unanimity principle and upholds the decision only if it can be integrated into a hypothetical bargain that embodies the sort of result all association members might have supported had they known of future circumstances prior to purchasing their units. In other words, a POA decision must bring about a situation that is Pareto-superior<sup>136</sup> to the situation the unit owners were in immediately after purchase.<sup>137</sup> In the usual case, a decision is

Levmore, *Explaining Restitution*, 71 VA. L. REV. 65, 68-69 (1985). Writers on corporate law, in particular, have examined, elaborated, and applauded the tendency. See, e.g., Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 291 (1986); Coffee, *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOKLYN L. REV. 919, 951-52 (1988).

134. *Beachwood Villas Condominium v. Poor*, 448 So. 2d 1143, 1145 (Fla. Dist. Ct. App. 1984) ("It would be impossible to list all restrictive uses in a declaration of condominium. . . . [T]he list is endless and subject to constant modification. . . .").

135. The Kaldor-Hicks concept of efficiency sometimes is called potential Pareto superiority. Under the Kaldor-Hicks formulation, a change is efficient if, after the gainers compensate the losers, the change is Pareto-superior. R. POSNER, *supra* note 13, at 12-13. Outcome *A* is said to be Pareto-superior to Outcome *B* if and only if at least one person is better off under *A* and nobody is worse off. *Id.* at 12. A decision will almost never be neutral, for if the benefits and costs of the decision are precisely in balance, the administrative costs of instituting a change render the decision inefficient.

136. On the concept of Pareto superiority, see *supra* note 135.

137. The following example illustrates why the time immediately after purchase is the initial benchmark for determining whether a particular decision is Pareto-superior and therefore reasonable. Assume a developer subdivides a tract of land into six lots, *A*, *B*, *C*, *D*, *E*, and *F*. Without any covenants at all, each lot is worth \$100,000. If the developer were to impose a covenant limiting all lots to residential purposes, the value of each lot would change. Posit further that Lots *A* and *B* adjoin a public thoroughfare and that the covenant would reduce their value by \$20,000 each while increasing the value of Lots *C*, *D*, *E*, and *F* by \$40,000 each. In these circumstances, the developer will adopt the covenant, for its net value is positive: an increase in total subdivision value of from \$600,000 to \$720,000. The purchasers of Lots *A* and *B* will pay only \$80,000 each for their lots. Their reduced purchase prices will compensate them in advance for the depressive effect of the restriction. Cf. Ellickson, *Alternatives*, *supra* note 19, at 714. See also Kell v. Bella Vista Village Property Owners Ass'n, 258 Ark. 757, 528 S.W.2d 651 (1975) (upholding disproportionate provision in documents of which unit purchaser had notice while

“unreasonable” if it causes a move away from Pareto optimality.<sup>138</sup> A decision that is efficient but not Pareto-superior can be rendered Pareto-superior by compensating owners who otherwise would suffer net losses.<sup>139</sup> If the decision is efficient, compensation will be necessary only if the decision disproportionately harms some owners, that is, if it affects their interests in ways in which those interests are not fungible. For example, if the board of directors levies a special assessment to raise funds for reconstruction of the clubhouse, all owners are likely to be affected fairly equally by the decision. The fact that such a decision is efficient will suffice to demonstrate that it is Pareto-superior and, therefore, “reasonable.” However, if in the course of its mediation function the association restricts leasing, if in the course of its preservation function it changes parking rules, or if in the course of its community enhancement function it obstructs a view, then the association must compensate unit owners who are net losers in order for the decision to be Pareto-superior and, therefore, “reasonable.”

From the foregoing, it is apparent that reasonableness review may be analyzed as a four-step process. First, the court determines if the decision is efficient.<sup>140</sup> If it is not, the decision is unreasonable and inquiry may end. Second, if the decision is efficient, the court must determine if at the time of adoption the decision affects all owners approximately equally or if it inflicts disproportionate harm on some owners. If it affects all owners equally, it is necessarily Pareto-superior and reasonable. The inquiry may end. Third, if the decision imposes disproportionate harm, the court must determine whether the complaining owners are really net losers. They would not be net losers, for example, if the decision caused an increase in their units' market value exceeding their losses.

stating that association did not have power to create further disproportionality). This example illustrates the error in some courts' belief that a covenant scheme is sustainable only if every lot in the subdivision is benefited more than burdened. *See, e.g., Anthony v. Brea Glenbrook Club*, 58 Cal. App. 3d 506, 130 Cal. Rptr. 32 (1976).

Suppose that the developer establishes a Property Owners Association for the governance of the subdivision, and after the developer has sold all lots to members of the public, the POA considers adopting a resolution to permit the establishment of a convenience store on Lot *F*. The existence of this store would increase the value of Lot *F* by \$20,000 and increase the value of Lots *A*, *B*, *C*, and *D* by \$15,000 each. But it would diminish the value of Lot *E* by \$10,000, for Lot *E* is located near Lot *F* and would suffer additional traffic and aesthetic losses. Assuming no other relevant factors (such as those set forth *infra* Part V. A.), such a decision would meet the Kaldor-Hicks definition of efficiency, for it would increase the value of the subdivision by the net amount of \$70,000. In the absence of compensation, however, it would not be reasonable, for it does not comply with the contract unanimity principle. The owner of Lot *E* would not have paid \$140,000 for a lot worth \$130,000. The decision to permit a convenience store on Lot *F* can be rendered Pareto-superior to the situation immediately following purchase, and therefore reasonable, by compensating the owner of Lot *E*.

138. *See Ackerman, Introduction, On the Role of Economic Analysis in Law* in *ECONOMIC FOUNDATIONS OF PROPERTY LAW* xii-xiii (B. Ackerman ed. 1975):

Outcome A is defined as Pareto-optimal if it is impossible to move to any other social state without making at least one person worse off in this new social state than he was under A. . . . [I]f an existing rule is not Pareto-optimal then (by definition) it should be possible to devise at least one new rule that is Pareto-superior to the existing state of legal affairs.

A move away from Pareto optimality will not *invariably* be unreasonable. The new decision need only be Pareto-superior to the position of the unit owners immediately after purchase; it need not be Pareto-superior to the situation immediately prior to adoption of the decision.

139. Professor Ellickson was the first commentator to advocate compensation of disproportionately impacted units, at least in the context of covenant amendments. His proposal that the courts employ the Michelman standards of compensability are probably unworkable, however, for the standards likely are unintelligible to most people, including many judges and lawyers. *See Ellickson, Cities, supra* note 4, at 1534-36.

140. The burden of persuasion differs in different kinds of cases. *See infra* Part V. B.

Similarly, they would not be net losers if the association, formally or informally, provided compensation sufficient to prevent anyone from being a net loser. If there are no net losers, the decision is Pareto-superior and reasonable. Fourth, if there are uncompensated net losers, the decision is not Pareto-superior. The court will invalidate the decision or construe it in a way to preserve its reasonableness.

#### D. *Parallels in Other Areas of Private Law*

Judicial employment of a review standard based on Pareto superiority and the hypothetical bargain is by no means limited to Property Owners Associations. On the contrary, the standard is employed throughout private law in assessing the "reasonableness" of coercive decisions—that is, decisions to which there has been no effective consent by the parties affected. In general, if *A* manages the collected assets of *X*, *Y*, and *Z*, and if *A* makes a decision to which *X*, *Y*, and *Z* have not effectively consented, then that decision will not survive judicial scrutiny if either *X*, *Y*, or *Z* is a net loser. This is so even if the decision is economically efficient for *X*, *Y*, and *Z* in the aggregate. In order for an efficient decision that harms *X* (while helping *Y* and *Z*) to pass judicial muster, *A* must include some arrangement, formal or informal, to compensate *X*.

A good illustration may be found in the law of trusts. If a trustee manages property for the benefit of a life beneficiary and a remainderman, the trustee may not invest in a way that disproportionately harms one beneficiary, even though the net result is good for the trust as a whole. If the trustee wishes to retain the investment, he must compensate the losing beneficiary from the gains of the winner. Thus, when a trustee purchases a wasting asset with a high current income and little future principal, some of the income must be "amortized," or allocated to the remainderman.<sup>141</sup> Similar bars to efficient but non-Pareto-superior actions may be found in the law of corporations,<sup>142</sup> mutual ben-

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141. 3A W. FRATCHER, *SCOTT ON TRUSTS* 184 (4th ed. 1988); *cf. id.* at 211 (allocating part of the sales price of property not producing income to life beneficiary).

142. In close corporation cases courts authorize dissolution for oppression of the minority where majority conduct defeats the minority's reasonable expectations. *Matter of Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984); *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983). *Cf. R. CLARK, CORPORATE LAW* 443-58 (1986); H. HENN & J. ALEXANDER, *LAWS OF CORPORATIONS* 997-1010 (1983) (statutory right of appraisal in business corporations, where the dissenting shareholder has the right to be bought out if he disapproves of certain extraordinary corporate actions). *See also* Easterbrook & Fischel, *supra* note 133.

An example in a quasi-public context is the monopolist's traditional duty to serve. When the sovereign grants to an entity the exclusive right to provide a good or service (thereby foreclosing consumer choice by government coercion), the good or service must be delivered in a fair and nondiscriminatory manner irrespective of considerations of efficiency maximization. On the duty to serve, see generally C. HAAR & D. FESSLER, *THE WRONG SIDE OF THE TRACKS* (1986). For a survey of the cases and literature of the subject, see C. HAAR & M. WOLF, *LAND USE PLANNING* 660-73 (1989).

efit societies and cooperatives,<sup>143</sup> running land covenants,<sup>144</sup> and mineral interests.<sup>145</sup>

I noted earlier that Professor Frug criticized Professor Ellickson for inconsistency by proposing that compensation, which Frug characterized as a public law principle, should be part of the private law of POAs.<sup>146</sup> We have seen, however, that compensation is very much a principle of *private* law, and was, in fact, imported into public law from the law applicable to private individuals and entities.<sup>147</sup> It is hardly surprising, therefore, that compensation should become part of the law of Property Owners Associations.<sup>148</sup>

## V. MEASURING UTILITY UNDER THE EFFICIENCY PRINCIPLE

### A. *Relevant Factors*

The first step in determining whether a POA decision is reasonable, that is, in determining whether it can be integrated into a hypothetical bargain, ordina-

143. In agricultural and other cooperative cases, the courts refuse to enforce bylaw amendments against members who joined previous to the amendments if such members would suffer disproportionate loss by reason of the change—even where the members had agreed at the time of joining that they would be bound by future changes. *See, e.g.,* *Whitney v. Farmers' Coop. Grain Co.*, 110 Neb. 157, 193 N.W. 103 (1923); *Lambert v. Fishermen's Dock Coop.*, 61 N.J. 596, 297 A.2d 566 (1972). *See also* Annotation, *Co-operative Associations: Validity and Enforceability of Bylaw Amendment Reducing Benefits Available to Members*, 61 A.L.R.3d 976 (1975).

144. One example is the changed conditions doctrine, under which old servitudes survive even if it would be economically efficient to remove them. They are invalidated only if the dominant estate no longer enjoys any benefit (other than nuisance value) from them. *See* *Riley v. Stoves*, 22 Ariz. App. 223, 526 P.2d 747 (1974); *Western Land Co. v. Truskolaski*, 88 Nev. 200, 495 P.2d 624 (1972); 2 AMERICAN LAW OF PROPERTY § 9.39 (A. J. Casner ed. 1952). *Cf.* Reichman, *Judicial Supervision*, *supra* note 4, at 158. *See also* *Petersen v. Beekmere, Inc.*, 117 N.J. Super. 155, 283 A.2d 911 (Ch. Div. 1971) (disallowing burden of assessment where it would impose a disproportionate burden on some owners in violation of contract expectancies); *Lakemoor Community Club, Inc. v. Swanson*, 24 Wash. App. 10, 600 P.2d 1022 (1979) (developer could not exercise reserved power to alter the covenants to impair lot purchasers' contract expectancies, even though lot owner had notice of reservation).

145. The executive right to lease the mineral interest of another cannot be exercised "so as to obtain benefits for O that would not also be shared by A." R. HEMINGWAY, *THE LAW OF OIL AND GAS* 48 (2d ed. 1983). The courts in oil-producing states have long struggled with how to interpret a grant of "other minerals" so as to avoid nonconsensual loss to either the surface owner or the mineral owner. For a review of some of this struggle and the Texas Supreme Court's decision to employ compensation principles in construing hypothetical bargains, see *Moser v. United States Steel Corp.*, 676 S.W.2d 99 (Tex. 1984).

146. *See, e.g.,* Frug, *supra* note 4, at 1591-92.

147. The requirement of compensation for takings by eminent domain was imported into federal law in the late 18th century but not into most state constitutions until well into the 19th century. M. HORWITZ, *TRANSFORMATION OF AMERICAN LAW* 63-64 (1977). Professor Horwitz notes both Blackstone's influence and contemporary natural law thinking as promoting the trend.

Such natural law thinking invoked what we now call the principle of Pareto superiority to limit government actions for which there is no effective consent. *See* MONTESQUIEU, *THE SPIRIT OF LAWS*, ch. 15 ("[W]hen the public has occasion for the estate of an individual, it ought never to act by the rigour of political law; it is here that the civil law ought to triumph, who with the eyes of a mother regards every individual as the whole community."). *See also* J. LOCKE, *OF CIVIL GOVERNMENT—SECOND TREATISE* (J.W. Gough ed. 1946). Examples of Pareto-superior standards appear at *id.* 15, 19, 24-25 (property can become individually owned and thus taken from the common stock only if no one is harmed). In Locke's model, as in private law generally, the Pareto-superior standard is no longer applicable where there is effective consent. *Id.* at 28, 30, 69.

Locke imported these theories of limitation upon the sovereign from compact principles of private law. *Id.* at 97, 101. Provisions for compensation for governmental takings represented, therefore, an effort to bind the sovereign power to the rules already governing private entities.

148. *See infra* Part VI. B.



rily will be ascertaining whether it is efficient. In this context, "an 'efficient' process is one which maximizes the total amount of welfare, of personal satisfaction, . . . and not all satisfaction is material."<sup>149</sup> Thus, a POA decision is "efficient" if utility gains from the decision outweigh utility losses.

Utility gains include both financial and nonfinancial gains. In the POA context, financial gains are of two kinds: those that are readily capitalized in increased fair market value of all or some units and those that can be measured only in other ways. An example of a gain reflected in fair market value is the gain in the value of most units resulting from a POA decision to restrict unit leasing.<sup>150</sup> Examples of other financial gains include higher interest yields on deposited association funds and savings in common property repair and cleaning costs. Examples of nonfinancial gains include decreased noise levels, aesthetic improvements, gains in freedom, and reduction of risk. Nonfinancial gains also include improvements in community participation and morale.

Utility losses are also of the financial and nonfinancial variety. Some of the financial losses may be capitalized into effects on fair market value. The same leasing restriction that increases the fair market value of a majority of the units may decrease the fair market value of the units currently leased.<sup>151</sup> Other financial losses are more difficult to capitalize, such as the amount of a special assessment, additional costs for repair and cleaning, settlement costs from payment of compensation,<sup>152</sup> and administrative costs.

Administrative costs can be particularly high when they include the expense of enforcing a decision against recalcitrant association members. The level of attorneys' fees authorized in some POA cases, for example, might be considered low in corporate litigation, but in the association setting the fees often seem disproportionate to the benefit gained or to the resources of the POA members who must foot the bill.<sup>153</sup> When the administrative costs of a decision are high, therefore, efficiency considerations might dictate that needed changes be brought about by negotiation between the POA and affected unit owners rather than by association fiat.<sup>154</sup>

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149. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1173 (1967).

150. See, e.g., *LeFebvre v. Osterndorf*, 87 Wis. 2d 525, 275 N.W.2d 154 (1979). A high number of leased units (over 30%) can impair significantly the market position of the subdivision. CALIFORNIA STUDY, *supra* note 12, at 7.

151. See, e.g., *LeFebvre*, 87 Wis. 2d 525, 275 N.W.2d 154.

152. "'Settlement costs' are measured by the dollar value of the time, effort, and resources which would be required in order to reach compensation settlements adequate to avoid demoralization costs." Michelman, *supra* note 149, at 1214.

153. See, e.g., *O'Buck v. Cottonwood Village Condominium Ass'n*, 750 P.2d 813 (Alaska 1988) (actual POA attorney fees of \$10,000 in dispute with unit owner over cable television; amount does not include sums due owner's attorney); *Chateau Village N. Condominium Ass'n v. Jordan*, 643 P.2d 791 (Colo. App. 1982) (POA incurred \$2400 in attorneys' fees through trial attempting to require owner to remove two cats from unit); *Lake Tippecanoe Owners Ass'n v. Hanauer*, 494 So. 2d 226 (Fla. Dist. Ct. App. 1986) (unit owner awarded attorneys' fees of over \$12,000 in POA's unsuccessful suit for alleged violation of restrictions); *Wimbledon Townhouse Condominium I Ass'n v. Kessler*, 425 So. 2d 29 (Fla. Dist. Ct. App. 1982) (fees denied where POA's law firm had expended over 40 attorney-hours in garage door dispute). Often in POA cases, enforcement of costs and fees is shifted to the losing party. This does not, however, affect overall utility, except insofar as the expense of shifting represents an administrative cost.

154. See *infra* Part VII.

Nonfinancial losses include reduction in individual and community morale and participation. Loss of morale may arise from aesthetic deterioration, reduction of freedom, increase in risk, or preclusion from harboring children or pets.

The findings of recent empirical studies are useful in assessing the relative utility gains and losses from specific decisions. Some of these findings co-exist only uncomfortably, if at all, with the ideological convictions of many scholars. For example, community heterogeneity, which many scholars see as a positive value, is in fact associated with severe association problems, including rule violations, assessment delinquencies, and low morale.<sup>155</sup> Scholars tend to place significant value on personal freedom, but empirical results, at least from condominium surveys, suggest resident satisfaction with the high degree of regulation typical of condominiums, especially if that regulation was in place when the unit owners purchased their units.<sup>156</sup> Similarly, some scholars emphasize the flexibility of the rule alteration power as an important association tool. The empirical studies, however, suggest that the alteration power ought to be employed sparingly because unit purchasers are risk-adverse—indeed, conservative in the extreme<sup>157</sup>—and alteration of the existing regulatory scheme is likely to result in considerable social unrest.<sup>158</sup>

155. See, e.g., FLORIDA STUDY, *supra* note 12, at 11, 14-15. Cf. CALIFORNIA STUDY, *supra* note 12, at 24-26 (factors correlating with increase in rule violations included, *inter alia*, increase in number of renters over last five years, life cycle heterogeneity, percentage of families with children, and percentage rentals); *id.* at 14-15 (factors correlating positively with member participation included, *inter alia*, fewer rentals, more members under 55, and homogeneity in age groups); *id.* at 22, 49 (factors correlating with assessment delinquency included, *inter alia*, percent rental and increase in rentals); CAI STUDY, *supra* note 12, at 27 (high rental rate coincides with high foreclosure rate); *id.* at 27-28 (high rental rate coincides with low quorum requirements); V. Walker, *supra* note 12, at 23 (membership selection devices reduce need to socialize new members).

The positive correlation between community morale, age homogeneity, absence of children, and members under 55 suggests an error in Congress' decision to limit no-child rules to retirement communities. Fair Housing Amendments Act, Pub. L. No. 100-430, § 6, 102 Stat. 1619, 1620-23 (1988).

156. For examples of condominium regulation, see *supra* note 25. In a survey of Florida condominiums, most residents surveyed disagreed with the statement that neighbors were nosy, most disagreed with the statement that power was too centralized, most thought apathy was the biggest problem, and most (81.2%) would buy the same condominium again. FLORIDA STUDY, *supra* note 12, at 64-69 (Questions 30, 9, 29, 35). A list of other questions revealed similarly high levels of satisfaction. *Id.* (Questions 6, 11, 13, 20, 26, 31, 33).

157. Among the factors rated as "very important" or "important" in a resident's decision to purchase Florida condominiums were security (85.2%), "rules and regulations which protect my investment and lifestyle" (92.6%), little or no maintenance work (89.5%), neighbors with similar values and lifestyles (71.7%), and professional management (67.9%). These indicia of conservatism are comparable to, and sometimes stronger than, more traditional reasons for buying real estate: price (89.2%), convenience of location (76.2%), recreational opportunities (76.7%), and quality of investment (74.0%). FLORIDA STUDY, *supra* note 12, at 55-56.

Although the age of the Florida respondents was high, unit purchasers' risk-adversity has been noted in other contexts. See, e.g., Ellickson, *Cities*, *supra* note 4, at 1525; Reichman, *Residential*, *supra* note 4, at 285. Cf. V. Walker, *supra* note 12, at 28 (economic value of privately owned unit higher in condominium owners' value hierarchy than group values).

158. See, e.g., FLORIDA STUDY, *supra* note 12, at 19-21, which discusses reactance, a response to a perceived loss of freedom due to association action. (Reactance is a marketing term.) In POAs its symptoms include demand for lost freedom, derogation of board of director's legitimacy, and psychological elevation to an exaggerated extent of the importance of the lost freedom. Of course, sometimes change is a necessary precondition to stability. See Note, *Condominium Rulemaking*, *supra* note 11, at 653.

Empirical results suggest that the POA context is no place to adopt Michelman's social reservation principle: [W]hen it has been formally declared, or when a tacit understanding has arisen, that society reserves the right to preempt the exploitation of a certain narrowly described class of resources at any time, and that no one is to form any inconsistent expectations about the future use and control of those resources.

Michelman, *supra* note 149, at 1240.

Generally, the loss of morale attendant upon alteration of the regulatory scheme becomes more severe as the alteration becomes more intrusive, especially when the alteration interferes with what Professor Radin calls an individual's "personhood."<sup>159</sup> Professor Radin distinguishes "fungible property"—that which is held only instrumentally and which may be replaced readily with goods of equal market value—from "personal property," the loss of which results in pain that is not readily compensable.<sup>160</sup> Professor Radin draws her examples of personal property principally from residential settings, and presumably she would classify an interest in a residential POA unit as the "personal property" of the individual who dwells there.<sup>161</sup> Arguably, many commercial POA units also qualify as "personal property." Many, if not most, businesses represent their owners' primary source of self-expression: such businesses are as much or more a part of their owners' personhood as written product is to a writer or as family is to a homemaker. Intrusion into real estate that serves as a principal business location is likely to be met with a resistance far more fierce than one might predict by examining merely the intrusion's cost in market or instrumental value.<sup>162</sup>

Each individual's personhood may be thought of as a dynamic system of which the physical body is the center, but which extends well beyond the body's limits.<sup>163</sup> To state that an item is "property"—or more precisely, to observe that an individual has a property right in an item—is to observe that the item is

159. Radin, *Property and Personhood*, 34 STAN. L. REV. 957 (1982).

160. *Id.* at 960-61.

161. For her comments on the home, see *id.* at 991-92. For discussion in the POA context, see FLORIDA STUDY, *supra* note 12, at 8-11.

162. *Cf.* Unit Owners Ass'n of Buildamerica-1 v. Gillman, 223 Va. 752, 292 S.E.2d 378 (1982). Examples of such resistance can be seen in the court and political battles individual business people waged during and after Urban Development Corporation condemnations in Newburgh, New York during the late 1960s and during and after the Crossroads Mall condemnations in Boulder, Colorado during the 1970s.

The importance of some business property to personhood seems to have passed unnoticed by many scholars, as is suggested by the economic term "consumer surplus" to describe value beyond market or instrumental value. Perhaps scholars overlook the personhood aspect of business enterprises because few of them have had entrepreneurial experience. Certainly anyone who has been a business owner for a significant length of time is deeply aware of the profound connection between business expression and personhood.

Professor Radin does discuss the "caricature capitalist," the person who "cannot express her nature without control over a vast quantity of things and other people." Radin classifies the caricature capitalist as a fetishist. Radin, *supra* note 159, at 970. However, this classification represents a moral judgment about values important to other individuals, and Professor Radin does not support it except by appeal to popular opinion. Moreover, this classification, even if useful, says nothing about thousands of real, noncaricature capitalists.

163. This is not to imply that one's body cannot be a part of another individual's personhood system as well as of one's own. Thus, parents have claims on the bodies of their children, spouses on those of their spouses, *cf.* J. LOCKE, *supra* note 147, at 39, and viable unborn children on those of their mothers. Some of these claims are enforceable in rem in varying degrees. When the state gives a private individual an unlimited or very wide claim on the body of another, the condition is slavery.

Under the personhood-as-system formulation, body parts *in situ* are personal property. Professor Radin leans against so classifying them, relying on "intuition." Radin, *supra* note 159, at 966.

Yet Radin's "intuition" is far from universal; among those not sharing it are Locke, the judges of the California Court of Appeal, and this writer. See J. LOCKE, *supra* note 147, at 15 ("[Y]et every man has a property in his own person; this nobody has any rights to but himself."); *Moore v. Regents of the Univ. of Cal.*, 202 Cal. App. 3d 1405, 249 Cal. Rptr. 494 (1988). I believe the most satisfactory formulation is to identify body parts *in situ* or removed but kept for sentimental reasons as (to employ Radin's terminology) "personal property"; other parts permanently removed but not abandoned as "fungible property"; and abandoned body parts as *res nullius* or, alternatively, part of the real estate where located.

within that system.<sup>164</sup> To state, in Professor Radin's terminology, that it is "fungible" property is to observe that it may be removed and replaced without systemic disruption; to state that it is "personal property" is to observe that interference with it necessarily causes systemic disruption. The symptoms of systemic disruption are physical damage, loss of morale, or both. Because individuals incorporate unique territories—particular locations—into their systems, loss of morale is often the result of territorial invasion.<sup>165</sup> This is why the courts in public takings cases, have been especially solicitous of the integrity of individually owned territory.<sup>166</sup> Courts reviewing POA decisions on reasonableness grounds also seek to protect against gross interference with the personhood system. They too have been notably solicitous of individually owned territory.<sup>167</sup>

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164. A more precise formulation of this private law principle would be as follows: To state that an item is Chauncey's "property" is to state either that it is within Chauncey's "system" and did not leave the system of another without that other's actual or constructive consent *or* that it has left Chauncey's system without Chauncey's actual or constructive consent. (By constructive consent, I mean to cover hypothetical bargain situations.) Thus, Chauncey's lost or stolen property, which is outside his system without his consent, remains his property. If Chauncey abandons an item, however, he places it outside his system by consent, and the item becomes the property of the first person to make it his own. J. DUKEMINIER & J. KRIER, *PROPERTY* 79 (2d ed. 1988).

The careful reader may respond that private law recognizes a number of instances in which rights and obligations (property) appear to shift among *sui juris* persons without apparent consent. Examples include estoppel and adverse possession, the former said to be based on "fairness" and the latter in part on public policy (efficiency).

Although this is not the place to argue the matter in detail, I doubt that these or analogous doctrines (such as acquiescence, waiver, and laches) are really exceptions to the consent rule. I suspect that they are the products of judicial investigation into the way real people, acting in the real world, tacitly consent to the transfer of rights and obligations—even if those real people later change their minds. Practitioners of private law, who encounter many questions regarding intent and almost none (after law school) regarding policy, would probably agree.

As the foregoing suggests, I am increasingly persuaded that much of the language of public welfare in private law cases is deceptive—that judicial conclusions regarding efficiency, when not merely dicta, elucidate the impact of conduct *on the parties*, and are therefore probative of what they did agree to or could have agreed to. *See, e.g.,* Humble Oil & Gas Ref. Co. v. West, 508 S.W.2d 812 (Tex. 1974) (purporting to employ public policy in structuring mutually beneficial hypothetical bargain). Efficiency, in other words, is primarily a tool for determining the scope of actual consent or the structure of the hypothetical bargain and, as the text indicates, is readily discarded as a controlling principle when it clashes with more convincing evidence on the subject.

165. Government is especially likely to compensate for "the stark spectacle of an alien, uninvited presence in one's territory." Michelman, *supra* note 149, at 1228.

166. *See, e.g.,* Nollan v. California Coastal Comm'n, 483 U.S. 825 (1987); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982); Kaiser-Aetna v. United States, 444 U.S. 164 (1979).

167. *E.g.,* Drabinsky v. Sea Gate Ass'n, 239 N.Y. 321, 146 N.E. 614 (1925). *See also* Chateau Village N. Condominium Ass'n v. Jordan, 643 P.2d 791 (Colo. App. 1982) (voiding board anti-pet decision); Winston Towers 200 Ass'n v. Saverio, 360 So. 2d 470 (Fla. Dist. Ct. App. 1978) (voiding rule against pets in unit on ground that rule was retroactive); Johnson v. Keith, 368 Mass. 316, 331 N.E.2d 879 (1975) (voiding rule against pets in unit based on narrow interpretation of statute); Board of Managers of Village House (A Condominium) v. Frazier, 81 A.D.2d 760, 439 N.Y.S.2d 360 (1981) (construing antileasing rule narrowly to permit overnight guests in unit); Holleman v. Mission Trace Homeowners Ass'n, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977) (POA right to regulate parking ended at lot line). The courts take a more indulgent attitude toward intrusive rules of which purchasers had notice upon purchase. As noted above, such rules are not subject to reasonableness review. *See, e.g.,* Cohan v. Riverside Park Place Condominium Ass'n, 333 N.W.2d 574 (Mich. Ct. App. 1983) (inspection of unit); River Terrace Condominium Ass'n v. Lewis, 33 Ohio App. 3d 52, 514 N.E.2d 732 (1986) (fumigation of unit); Preston Towers Condominium Ass'n v. S.B. Realty, 685 S.W.2d 98 (Tex. Ct. App. 1985) (antichild rule). *Cf.* Constellation Condominium Ass'n v. Harrington, 467 So. 2d 378 (Fla. Dist. Ct. App. 1985) (age restrictions bifurcated; part in existence when defendant moved in enforced, but amendment not enforced).

The approach of protecting the personhood system, especially within the POA unit, may be in accord with the expectations of most unit purchasers, who, as former fee owners and tenants, are accustomed to the notion of having exclusive possession. *Cf.* FLORIDA STUDY, *supra* note 12, at 8-10.

### B. Judicial Review of POA Utility Determinations

The courts have adopted several methods of reviewing association determinations of utility. One method is to examine a board determination upon an evidentiary standard similar to that which might be applied if an appellate court were reviewing the decision of a finder of fact; if there is any inferable evidence for the determination, it is sustained.<sup>168</sup> A second method of review is the hearing de novo. This is the trial judge's procedure in a significant group of reported cases.<sup>169</sup> The burden of persuasion generally is placed upon the association: the POA must demonstrate that its decision is supported by the evidence. A third method, often employed in conjunction with either of the first two, is for the court to examine the process the POA undertook in arriving at its decision. If the process is deemed adequate, the decision is likely to be upheld.<sup>170</sup> This third method is analogous to the "informed consent" condition to immunity under the business judgment rule. One must hasten to add, however, that not all POA cases reciting the business judgment rule have considered process to be relevant,<sup>171</sup> and not all cases in which process was deemed relevant were cases in which the court recited the business judgment rule.<sup>172</sup>

With nearly perfect regularity, the courts have adopted the first method (minimal review) in cases in which the association is administering its common property or common finances and have adopted the second method (de novo review) when the association is limiting the use of individually owned property.<sup>173</sup> The third method, procedural review, is employed to examine association financial dealings, usually in conjunction with a minimal evidence standard.

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168. *Farrington v. Casa Solana Condominium Ass'n*, 517 So. 2d 70 (Fla. Dist. Ct. App. 1987); *Hidden Harbour Estates v. Norman*, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975); *River Terrace Condominium Ass'n v. Lewis*, 33 Ohio App. 3d 52, 514 N.E.2d 732 (1986); *San Antonio Villa Del Sol Homeowners Ass'n v. Miller*, 761 S.W.2d 460 (Tex. Ct. App. 1988).

169. See *O'Buck v. Cottonwood Village Condominium Ass'n*, 750 P.2d 813 (Alaska 1988); *Ironwood Owners Ass'n IX v. Soloman*, 178 Cal. App. 3d 766, 224 Cal. Rptr. 18 (1986); *Laguna Royale Owners Ass'n v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981); *Lyons v. King*, 397 So. 2d 964 (Fla. Dist. Ct. App. 1981); *Hidden Harbour Estates v. Basso*, 393 So. 2d 637 (Fla. Dist. Ct. App. 1981); *Yorkshire Village Community Ass'n v. Sweasy*, 170 Ill. App. 3d 155, 524 N.E.2d 237 (1988); *Cohan v. Riverside Park Place Condominium Ass'n*, 333 N.W.2d 574 (Mich. Ct. App. 1983); *Courts at Beachgate v. Bird*, 226 N.J. Super. 631, 545 A.2d 243 (Ch. Div. 1988). Cf. *Smith v. Butler Mtn. Estates Property Owners Ass'n*, 90 N.C. App. 40, 367 S.E.2d 401 (1988), *aff'd*, 324 N.C. 80, 375 S.E.2d 905 (1989) (trial court could adopt independent basis for upholding POA decision even if POA did not adopt that basis).

170. See *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981) (process inadequate); *Papalexiov v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch.Div. 1979) (process adequate); *San Antonio Villa Del Sol Homeowners Ass'n v. Miller*, 761 S.W.2d 460 (Tex. Ct. App. 1988) (process adequate).

171. *Rywalt v. Writer Corp.*, 34 Colo. App. 334, 526 P.2d 316 (1974).

172. *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977).

173. The one significant exception to date is *River Terrace Condominium Ass'n v. Lewis*, 33 Ohio App. 3d 52, 514 N.E.2d 732 (1986), in which the court specifically disclaimed the power of de novo review of a POA decision to enter a unit to exterminate cockroaches. However, the decision was so clearly within the power of the association, whose governing documents specifically gave it rights of access for maintenance purposes, that the real wonder is why the court consumed well over 3000 words (including nine dense footnotes) to dispose of the matter. Even in this case the trial court had held a full evidentiary hearing on the merits.

Occasionally it is utilized to heighten the de novo review employed when the POA regulates individually owned units.<sup>174</sup>

De novo and procedural review can be justified only if their benefits exceed their cost. In cases involving POA regulation of individual units de novo review serves the purposes of protecting the territorial and liberty expectancies of individual owners and of reducing opportunities for oppression. When the association permits a new use, compensation for neighbors adversely affected might be a cheaper and fairer substitute for de novo review.<sup>175</sup> When the association prohibits a proposed new use, compensation of the restricted owner is not a viable alternative to de novo review, for the association may maintain that because it was merely preserving the status quo under pre-existing documentation, no compensation is needed. In the latter case the court probably will not be able to avoid the cost of a full evidentiary hearing, so it would gain little by avoiding the de novo standard.

Procedural review has attracted recent attention in the business corporation setting due to the Delaware Supreme Court's decision in *Smith v. Van Gorkom*,<sup>176</sup> but the judiciary was applying it in the POA setting well before *Van Gorkom*. A judge's goal in applying procedural review is to ensure that the POA decisionmakers undertook a responsible investigation before imposing expenses or other burdens on their fellow unit owners. Proper procedures tend to demonstrate that the decisionmakers acted in good faith and on an informed basis. In the course of procedural review judges have considered whether the decisionmakers kept records to substantiate the alleged problem they were trying to solve,<sup>177</sup> whether they notified and consulted other unit owners on the impending decision,<sup>178</sup> whether they evaluated alternatives,<sup>179</sup> whether they consulted legal counsel<sup>180</sup> or other experts,<sup>181</sup> whether a special committee met to assess the issue,<sup>182</sup> and whether they thoroughly discussed the issue among themselves.<sup>183</sup> Of course, not all of these steps are deemed necessary for every

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174. See *Washington Courte Condominium Ass'n-Four v. Cosmopolitan Nat'l Bank*, 169 Ill. App. 3d 1059, 523 N.E.2d 1245 (1988) (litigation costs); *The Courts at Beachgate v. Bird*, 226 N.J. Super. 631, 545 A.2d 243 (Ch. Div. 1988) (structural modification of unit); *Papalexio v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979) (special assessment); *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981) (security deposit for landlords); *San Antonio Villa Del Sol Homeowners Ass'n v. Miller*, 761 S.W.2d 460 (Tex. Ct. App. 1988) (special assessment).

175. Cf. *Cohen v. Kite Hill Community Ass'n*, 142 Cal. App. 3d 642, 191 Cal. Rptr. 209 (1983) (POA approval of architectural change not provided for in bylaws is proper basis for cause of action against the association). Court costs can be avoided by the use of mediation devices. See *infra* note 221 and accompanying text.

176. 488 A.2d 858 (Del. 1985).

177. *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981).

178. *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977).

179. *The Courts at Beachgate v. Bird*, 226 N.J. Super. 631, 545 A.2d 243 (Ch. Div. 1988); *Papalexio v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979).

180. *Papalexio v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979).

181. *San Antonio Villa Del Sol Homeowners Ass'n v. Miller*, 761 S.W.2d 460 (Tex. Ct. App. 1988).

182. *Washington Courte Condominium Ass'n-Four v. Cosmopolitan Nat'l Bank*, 169 Ill. App. 3d 1059, 523 N.E.2d 1245 (1988).

183. *Papalexio v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979); *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977).

determination; the magnitude and complexity of each decision suggest the scope of preparation required.<sup>184</sup>

Commentators have questioned the efficiency of procedural review of board actions in the context of for-profit corporations. Professors Macey and Miller argue, for example, that "in general the increased 'papering' of board decisions will not substantially raise the level of deliberations . . . because of the ease with which corporate boards, aided by a phalanx of sophisticated lawyers and investment bankers, can cloak result-oriented decision-making in the guise of careful deliberation."<sup>185</sup> This argument is based in part upon the long business experience of many corporate directors (a combined total of 121 years in *Van Gorkom*), the speed with which many corporate decisions must be made, and the ultimate shifting of knowledge acquisition costs to the shareholders when outside firms make offers based on information they acquire themselves.<sup>186</sup> Whatever the weight of these drawbacks as applied to business corporations, they have little weight in the POA context, in which the time pressure imposed by the business world is almost unknown, information costs are low, the association may control the bidding procedure, and decisions are made by association officials with short tenures and little or no business experience.<sup>187</sup>

Although procedural review is more expensive than the minimal evidentiary standard alone, it is likely less expensive than a hearing de novo. Without looking beyond documentary evidence, a court may be able to determine whether the decisionmakers consulted experts, conducted meetings, solicited bids, and undertook other preparatory investigation. Procedural review is therefore likely to be efficient in POA cases. Unless the decision has imposed disproportionate harm on particular owners, procedural investigation coupled with a minimal evidentiary standard should be sufficient to determine if the decision is reasonable.

## VI. MEASURING HARM UNDER THE UNANIMITY AND COMPENSATION PRINCIPLES

### A. *Efficient Decisions in Which There Are No Net Losers*

Once a court determines that a decision is efficient, the court must ascertain whether at the time of adoption the decision harmed some unit owners disproportionately. Disproportionate harm to a complaining member is calculated by identifying the impact on that member of the same factors, financial and nonfinancial, that are considered in determining the decision's overall efficiency.<sup>188</sup>

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184. Natelson, *Fiduciary*, *supra* note 11, at 447-49.

185. Macey & Miller, *Trans Union Reconsidered*, 98 *YALE L.J.* 127, 139-41 (1988).

186. *Id.* at 142.

187. Natelson, *Fiduciary*, *supra* note 11, at 445-46. Since that article appeared, the inexperience and limited knowledge of most POA board members has been documented empirically. See CALIFORNIA STUDY, *supra* note 12, at 12. The median length of service on a POA board is two years. *Id.* at 29.

188. See *supra* Part V. A.

Some kinds of harm are inherently proportionate. A special assessment allocated according to the assessment-payment percentages set forth in the POA's governing documents is not disproportionate, even if the percentages in the governing documents are unequal. When a POA levies an assessment according to those percentages, a court that finds the decision efficient routinely sustains the levy without further inquiry.<sup>189</sup>

Because the POA's mediation function involves reconciling the interests of different unit owners, disproportionate effects are more likely to occur when the association exercises that function than when it exercises the preservation and community enhancement functions. A decision permitting one unit owner to erect a large antenna, for example, may inhibit another unit owner's pristine view. Yet many mediation decisions are without disproportionate effects. In *Dulaney Towers Maintenance Corp. v. O'Brey*,<sup>190</sup> for example, a married couple purchased a condominium apartment and moved in. They brought their pet poodle with them. Some time later, the board of directors adopted a rule limiting each owner to one dog or cat and exempting all current pets from the rule. At the time this regulation was adopted it had no effect on the couple, but when they acquired a second dog, the association was able to convince the court, purely on efficiency grounds, to enforce the rule.<sup>191</sup>

If the court finds that a decision does impose disproportionate harm, the court must determine whether the complaining owners are *net* losers. If the decision affords them benefits that outweigh their injury, the regulation is enforced without compensation. Cases of this nature generally involve "harm" so trivial as to cause the reader to wonder why the matter was ever litigated.<sup>192</sup> An excellent example is *Rywalt v. Writer Corp.*,<sup>193</sup> in which a Colorado appellate panel upheld an association decision to construct a second tennis court despite complaints from two owners that the tennis court would reduce the quality of their view and their ease of access to other common areas. The loss must have been *de minimis*, for these owners were unable to demonstrate sufficient harm to support injunctive relief, although the trial judge decided for them on other grounds. On appeal, the complaint was dismissed. Any harm the owners suffered was outweighed by their aliquot portion of the benefits of the the new tennis court, a facility that the developer had agreed to finance and that would cost the association nothing. Cases such as *Rywalt* suggest that the dispropor-

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189. *E.g.*, *Papalexioiu v. Tower W. Condominium*, 167 N.J. Super. 516, 401 A.2d 280 (Ch. Div. 1979); *San Antonio Villa Del Sol Homeowners Ass'n v. Miller*, 761 S.W.2d 460 (Tex. Ct. App. 1988).

190. 46 Md. App. 464, 418 A.2d 1233 (1980).

191. *Id.* at 466, 418 A.2d at 1235 (citing need for "harmonious residential atmosphere" and odors, noise, health hazards, and cleaning and maintenance problems caused by pets).

192. In some cases, injury too trivial to justify suit otherwise will be adjudicated because it is part of a larger case, or because the parties have become polarized. The latter phenomenon is extremely common in POAs. *See CALIFORNIA STUDY, supra* note 12, at 16 (harassment of POA officials); *FLORIDA STUDY, supra* note 12, at 34-36 (complaints to state agency); *R. NATELSON, supra* note 6, at 114-15, 438 (harassment by officials).

On the need in the public law context to take into account the benefits of a regulation upon a complaining individual in order to determine whether there has been a compensable net loss, see *Agins v. City of Tiburon*, 447 U.S. 255, 262 (1980).

193. 34 Colo. App. 334, 526 P.2d 316 (1974).



tionate impact, if any, of a wide range of common property administrative decisions is so minimal that it can be safely ignored.<sup>194</sup>

### B. *Compensating When There Are Net Losers*

In many instances, an efficient association decision disproportionately harms a complaining unit owner to such an extent that the injury he suffers exceeds the benefit accruing to him. In that event, the decision is not Pareto-superior and will not survive reasonableness review. However, the decision can be rendered Pareto-superior by the adoption of formal or informal compensation arrangements. For purposes of illustration, if a new rule requiring removal of pets entails only one gain, increase in market value, and only one injury, loss of morale, then the rule is reasonable if (a) the increase in market value exceeds loss of morale for all pet owners, or (b) the association can and does adequately compensate any unit owner for whom loss of morale exceeds increase in market value.

Besides preserving Pareto superiority, compensation arrangements help to ensure that association decisions actually are efficient, for if benefited owners know they must compensate burdened owners, benefited owners will take more care to arrive at only wealth-enhancing decisions.<sup>195</sup> In addition, compensation eliminates Professor Michelman's demoralization costs:

the total of (1) the dollar value necessary to offset disutilities which accrue to losers and their sympathizers specifically from the realization that no compensation is offered, and (2) the present capitalized dollar value of lost future production (reflecting either impaired incentives or social unrest) caused by demoralization of uncompensated losers, their sympathizers, and other observers disturbed by the thought that they themselves may be subjected to similar treatment on some other occasion.<sup>196</sup>

According to Professor Michelman, compensation should be necessary only when failure to compensate would be "critically demoralizing," that is, when demoralization costs from failing to compensate exceed settlement costs from compensating. Nevertheless, it would be a rare POA case in which the settlement costs of compensating for significant disproportionate damage would exceed demoralization costs. POA settlement costs are low, for injured owners usually are few and readily identifiable. But community morale is at a pre-

194. See, e.g., *Hidden Harbour Estates, Inc. v. Norman*, 309 So. 2d 180 (Fla. Dist. Ct. App. 1975), the most cited of all reasonableness review cases. The parties in *Hidden Harbour* battled to the appellate level on the capital issue of whether a condominium board of directors could prohibit alcoholic beverages in the association clubhouse. The Florida court that sustained the rule noted that such restrictions were very common; presumably the court's point was that they served a useful purpose whose benefits to the complaining parties outweighed any harm to the complaining parties. Arguably, also, protection of the POA's general power to regulate the clubhouse benefited the complaining parties more than the challenged exercise harmed them. Of course, if the restriction had been applied throughout all common areas or in individual units, the result might have been different.

195. "Thus, it would appear that any measure which society cannot afford or, putting it another way, is unwilling to finance under conditions of full compensation, society cannot afford at all." Michelman, *supra* note 149, at 1181. See *San Diego Gas & Elec. Co. v. City of San Diego*, 450 U.S. 621, 661 n.26 (1981) (Brennan, J., dissenting).

196. Michelman, *supra* note 149, at 1214 (footnotes omitted). In a POA demoralization cost would be reflected in, *inter alia*, poor owner participation, poor property maintenance, and high rule violation rates. See, e.g., CALIFORNIA STUDY, *supra* note 12, at 13-16, 23-26.

mium: the POA relies heavily on unpaid, part-time officials and on voluntary compliance.<sup>197</sup> The latter is especially important because association rule enforcement mechanisms are inefficient, expensive, and slow. Moreover, POA redistribution decisions do not have the legitimacy granted to government redistribution policies.<sup>198</sup>

As a preparatory basis for examining how the POA compensation principle works, it is helpful to review Calabresi and Melamed's formulation of the alternatives available to a court when it considers how to respond to conflicting land uses.<sup>199</sup> In the context of a disputed POA regulation banning a particular use, these alternatives may be stated as follows: First, the court may specifically enforce the regulation without awarding compensation to the unit owner (unconditional specific relief). Second, it may permit the unit owner to continue the use, but require him to pay compensation to the association (money damages or conditional immunity). Third, the court may refuse to enforce the regulation in any respect (unconditional immunity). Fourth, it may specifically enforce the rule on the condition that the association pays compensation to the unit owner (conditional specific relief).<sup>200</sup>

The first and third alternatives, unconditional specific relief and unconditional immunity, theoretically leave the losing party with the option of purchasing the entitlement of the winner. If the losing party elects to do so, the effect is to permit him to enjoy his land use preferences while paying negotiated compensation. According to the Coase Theorem,<sup>201</sup> in a world without transaction costs the losing party would purchase the winner's entitlement if the losing party's preferred state of affairs were more valuable to him than the entitlement was to the winner. Such a purchase would establish that the losing party's state of affairs is more economically efficient. In the second and fourth alternatives, conditional immunity and conditional specific relief, the court bestows an entitlement, but conditions it upon the payment of compensation. It also fixes the amount of compensation. If the party with the less efficient preference is ordered to pay compensation, that party will yield his preference rather than continue it at the court-ordered cost.

197. CALIFORNIA STUDY, *supra* note 12, at 12-13.

198. *Cf.* Michelman, *supra* note 149, at 1181. Because POAs are not granted power to redistribute for egalitarian purposes, critical demoralization is more likely to occur from redistributive POA decisions than from redistributive governmental decisions. A governmental redistribution decision often is socially acceptable because "its evident purpose is to redistribute from the better off to the worse off." *Id.* at 1182.

199. Calabresi & Melamed, *supra* note 133, at 1115-24. I have avoided Calabresi and Melamed's terms for specific and substitutionary relief ("property rules" and "liability rules"), not seeing what advantage they offer to offset the confusion they may engender. The terms "conditional immunity" and "conditional specific relief" are my own.

200. *See, e.g.,* *Spur Indus. v. Del E. Webb Dev. Co.*, 108 Ariz. 178, 494 P.2d 700 (1972).

201. The Coase theorem states that "if transactions are costless, the initial assignment of a property right will not determine the ultimate use of the property." R. POSNER, *supra* note 13, at 7. Under this theory, if it is more efficient to eliminate pets from the subdivision than to keep them and a rule against pets is invalidated, the POA will purchase the acquiescence of pet owners. If it is not more efficient to eliminate pets from the subdivision than to keep them, the POA will not bother.

If a court were operating from a purely utilitarian standpoint, then it would bestow the entitlement exclusively on efficiency grounds.<sup>202</sup> Assume that Rebecca leases her unit to a tenant in violation of a POA antileasing rule. If it is more socially efficient for Rebecca to lease, the court ought to grant her immunity, either absolute (third alternative) or conditional upon payment of compensation to the association (second alternative). If it is more efficient to enforce the antileasing rule, the court ought to grant the POA specific relief, either absolute (first alternative) or conditional on payment of compensation (fourth alternative).

Once a utilitarian court chooses between specific relief and immunity, it must determine whether the remedy should be absolute or conditional on payment of compensation. If damages would be difficult to quantify or negotiation would not involve prohibitive transaction costs, then *ceteris paribus* specific relief or immunity ought to be unconditional. If damages are capable of calculation or negotiation would be overly expensive, then *ceteris paribus* the court should fix an amount of compensation.

As already suggested,<sup>203</sup> the results of the "consent" cases—those in which a purchaser acquired a unit while accepting a pre-existing decision—are easy to explain on utilitarian or efficiency principles. In each of these cases there is little question as to which result is efficient. As between the complaining unit owners and all of their satisfied neighbors, the unit owners are the least cost avoiders, for they knew (or easily could have known) of the pre-existing situation and could have elected to buy elsewhere. Their neighbors also knew of the pre-existing situation and in many instances relied upon it.<sup>204</sup> Thus, in nearly all of the consent cases the courts have granted the entitlement to the association.

In selecting between absolute specific relief and specific relief conditional on compensation, courts hearing "consent" cases almost invariably grant unconditional specific relief. Compensation might be difficult to calculate, and it would damage community morale by rewarding people for having disregarded known rules. Another alternative—granting the POA only money damages—is never selected. It also would involve problems of calculation<sup>205</sup> and loss of morale in an atmosphere in which equal application of the rules approximates a moralism.<sup>206</sup>

202. Recall that under the Michelman formulation, not all efficiency is material. See *supra* note 149 and accompanying text. Social efficiency must be calculated by considering such items as general happiness, settled precedent, and predictability, as well as financial benefits.

203. See *supra* text following note 111.

204. See, e.g., *Riley v. Stoves*, 22 Ariz. App. 223, 526 P.2d 747 (1974).

205. The most likely error is on the side of undercompensation—compensating the other POA members for current losses rather than the complete losses they suffered from misplaced reliance on documents that purported to prohibit the use. If the damages were not undercompensatory, they would have the effect of eliminating the use, because it is inefficient in the larger scheme of things.

206. *White Egret Condominium, Inc. v. Franklin*, 379 So. 2d 346 (Fla. 1979). One empirical study of POAs found an inverse correlation between rule violation and community participation. CALIFORNIA STUDY, *supra* note 12, at 23-24, 50. Common sense might suggest that a decrease in community morale of the kind that reduces participation would increase rule violations, if only because participation leads to better communication of the rules. Dr. Walker reports an inverse correlation between officer-member communication and rule violation. Telephone Interview, *supra* note 97.

If perchance the nonconforming owner wished to buy the entitlement and the association agreed, transaction costs would be low. There is only one association; its unified nature precludes holdout problems. There usually are few violators, and therefore few potential free riders; if there are many violators the reason usually is that the association has not been diligent, in which event the court denies injunctive relief.<sup>207</sup>

We have seen that the association receives unconditional specific relief when it seeks to enforce decisions to which individual unit owners have not consented, but which benefit the owners at least as much as they harm them.<sup>208</sup> If the harm outweighs the benefit to owners who are disproportionately affected, unconditional specific relief is no longer an option, and it is never granted.

When POA action has the potential of inflicting disproportionate loss on some unit owners, there are several ways, both judicial and extra-judicial, of accomplishing at least some of the association's goals while preserving Pareto superiority. An extra-judicial method is for the association to adopt regulations with loopholes sufficient to avoid the most serious kind of unit owner damage in the hope of establishing a situation in which each unit owner's benefits exceed his losses.<sup>209</sup> A related judicial method is to construe a regulation narrowly to preserve some of its purpose while avoiding particularly harmful results.<sup>210</sup>

When associations cannot flatly prohibit an activity without inflicting disproportionate harm, they often draft their regulations to permit the activity, while requiring unit owners engaging in it to compensate the association for harmful externalities. This is a nonjudicial equivalent of Calabresi and Melamed's second alternative, conditional immunity (substitutionary relief). The approach is common in leasing restrictions,<sup>211</sup> and it has not been challenged

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207. *White Egret*, 379 So. 2d 346. This is the waiver, estoppel, or selective enforcement doctrine. It is possible to justify this doctrine on economic grounds because past nonenforcement tends to show that the cost of offending behavior is lower for the POA than the cost of stopping it would be for the unit owner. Moreover, when there are many violators their organization costs are higher than those of the POA. *Ceteris paribus*, efficiency dictates imposing an injunction on the party with lower organization costs or (what is much the same thing) granting unconditional immunity to the party with higher organization costs. Alternatively, this doctrine may reflect no more than judicial recognition of transfer of rights by consent. See *supra* note 164.

208. See *supra* text accompanying notes 192-94.

209. *E.g.*, *Seagate Condominium Ass'n v. Duffy*, 330 So. 2d 484 (Fla. Dist. Ct. App. 1976) (permitting hardship leases); *Kroop v. Caravelle Condominium, Inc.*, 323 So. 2d 307 (Fla. Dist. Ct. App. 1975) (permitting leasing once during period of ownership); *Dulaney Towers Maintenance Corp. v. O'Brey*, 46 Md. App. 464, 418 A.2d 1233 (1980) (present pet population excepted from rule); *Preston Tower Condominium Ass'n v. S.B. Realty*, 685 S.W.2d 98 (Tex. Ct. App. 1985) (babies in early gestation at time of purchase excepted from antichild rule). See also CAI STUDY, *supra* note 12, at 33-35 (some condominiums prohibited renting except for hardship or for one time during period of ownership).

210. *Board of Managers of Village House (A Condominium) v. Frazier*, 81 A.D.2d 760, 439 N.Y.S.2d 360 (1981) (construing antileasing rule to permit guests); *Holleman v. Mission Trace Homeowners Ass'n*, 556 S.W.2d 632 (Tex. Ct. Civ. App. 1977) (construing antiparking rule so as to permit parking on individually owned portion of driveway). *Cf.* *Bush Terrace Homeowners Ass'n v. Ridgeway*, 437 N.W.2d 765 (Minn. App. 1989) (holding that association had exceeded scope of architectural rule in ordering removal of screens used to keep out wasps, when unit owner had severe allergies).

211. One study found leasing amendments to be the most common substantive bylaw change. CAI STUDY, *supra* note 12, at 23. This study identified the percentage of condominiums with different kinds of restrictions. Only 1.1% of condominiums totally prohibited leasing. Among the restrictions employed to reduce leasing externalities or compensate the POA for them were the following: Board must approve tenants (20.7%); board must approve leases (30.4%); leases must contain certain clauses (34.4%); leases must be in writing (42.7%); leases

very frequently. There is only one reported case in which such a regulation was adopted after the complaining owner's purchase.<sup>212</sup> The regulation in question would have required landlords to provide the POA with a security deposit to compensate for tenant damage. The court invalidated the rule, apparently concluding that the association had not proven that there was much tenant damage; better proof might have yielded a different result.<sup>213</sup>

Still another option for preventing disproportionate harm is Calabresi and Melamed's fourth alternative—injunction coupled with compensation to the member. This result usually is accomplished by a combination of association ingenuity and judicial cooperation. An interesting illustration appears in a recent Alaska case.<sup>214</sup> The association board of directors had removed all roof antennas in order to eliminate leaks and to improve aesthetics and unit marketability. The O'Bucks, inveterate television watchers and owners of four television sets, sued to have their antenna replaced. They lost, however, because the association had compensated them in a number of ways. It had paid the O'Bucks for the value of the antenna it removed, it had installed a new cable system that provided them with the same or similar programming, and it had offered to pay their fee for hooking into the new system. The O'Bucks' only uncompensated cost was a small monthly charge that was more than equaled by the improvement in marketability of each unit.<sup>215</sup>

## VII. PROTECTION OF PERSONHOOD INTERESTS

When enforcement of a nonconsensual POA decision would cause substantial loss of morale to an owner by intruding into the personhood system, the decision cannot be integrated into a hypothetical bargain, and a court grants complete immunity to the owner. As noted earlier, a POA usually threatens to invade the personhood system by adopting a decision designed to intrude into an owner's control over his individual territory.<sup>216</sup> *Drabinsky v. Sea Gate Association*,<sup>217</sup> discussed earlier, may serve as an example. Had the limit of ten guests per day been upheld, the association would have effectively regulated not merely the common streets, but Mr. Drabinsky's domestic life as well. Similar consid-

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must have a minimum term (37.2%); owners must notify association of the name of the tenant (64.8%); one time fee (23.4%); monthly fee (5.9%); tenant rule violation is a default in the lease (67.9%). *Id.* at 33-35.

212. *Coventry Square Condominium Ass'n v. Halpern*, 181 N.J. Super. 93, 436 A.2d 580 (Dist. Ct. 1981).

213. This case is criticized in R. NATELSON, *supra* note 6, at 159-60. Both increased rule violation and assessment delinquency correlate empirically with percentage of units leased and with percentage increase in units leased. CALIFORNIA STUDY, *supra* note 12, at 22, 24-26, 49. If the finding of no damage is accepted, the case merely reflects the judicial policy against POA redistribution. *Cf. Thanasoulis v. Winston Towers 200 Ass'n*, 110 N.J. 650, 542 A.2d 900 (1988).

214. *O'Buck v. Cottonwood Village Condominium Ass'n*, 750 P.2d 813 (Alaska 1988).

215. *See also Juno by the Sea N. Condominium Ass'n (The Towers) v. Manfredonia*, 397 So. 2d 297, 305 (Fla. Dist. Ct. App. 1981) (on rehearing) (scheme of limited common element maintenance provided effective compensation for allocation of parking units to all owners); *Board of Managers of Village House (A Condominium) v. Frazier*, 81 A.D.2d 360, 439 N.Y.S.2d 360 (1981) (sustaining board rejection of a prospective tenant or purchaser when the operative documents provide for an association buyout or right of first refusal).

216. *See supra* note 167 and accompanying text.

217. 239 N.Y. 321, 146 N.E. 614 (1925).

erations have induced the courts to strike down pet and child restrictions that otherwise seem quite reasonable.<sup>218</sup>

Although the courts sometimes grant complete immunity when the unit owner's disproportionate loss is "fungible,"<sup>219</sup> the potential for significant loss of morale is usually what induces the judiciary to bestow complete immunity. Often the projected gain from a pet restriction is speculative, while the potential demoralization of unit owners can be substantial and difficult for a court to quantify. Often, too, the POA can obtain a desired result, such as the silencing of an obnoxious dog, by methods short of promulgating a general rule.<sup>220</sup>

When a POA desires to adopt an efficient rule that might impose substantial unquantifiable losses on a minority, the POA should seek to negotiate with members of the minority to arrive at a price for their cooperation. Empirical results suggest that it would be helpful to utilize mediation services during the negotiations.<sup>221</sup> If the measure is truly efficient, the association should be able to afford the negotiated prices.

There remains the problem of transaction costs. Negotiations might be time-consuming and expensive. However, the time and cost of negotiating with dissident owners is unlikely to match the time and cost of obtaining judicial enforcement. The expense of suing recalcitrant members may prove to be high enough to eliminate any utility gains from enforcement of the decision.<sup>222</sup>

One reason generally given for granting specific instead of substitutionary relief is that within the context considered, negotiation would be inexpensive. In the POA context, negotiation costs are indeed lower than in many other situations. As a single entity with the power to assess its members for the costs of its operations, the POA has low organization costs and few, if any, free riders. The number of nonconforming members is usually relatively low; otherwise, a rule against their use would not be efficient. There is the risk that some of them will hold out—will refuse to negotiate for any reasonable price. However, holdouts are eliminated as they die or move, and each POA decision adopted during their terms of ownership is enforceable against their transferees. Moreover, recent empirical findings suggest that scholars may have exaggerated the problem of

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218. *Chateau Village N. Condominium Ass'n v. Jordan*, 643 P.2d 791 (Colo. App. 1982) (board sought to prevent additional pets; policy struck down as unreasonable); *Winston Towers 200 Ass'n v. Saverio*, 360 So. 2d 470 (Fla. Dist. Ct. App. 1978) (rule against *additional* pets invalidated as retroactive); *Johnson v. Keith*, 368 Mass. 316, 331 N.E.2d 879 (1975) (antipet rule of which purchaser knew invalidated on interpretation of ambiguous statute). *Cf.* *Constellation Condominium Ass'n v. Harrington*, 467 So. 2d 378 (Fla. Dist. Ct. App. 1985) (invalidating amendment to antichild rule as retroactive).

219. *E.g.*, *Monell v. Golfview Road Ass'n*, 359 So. 2d 2 (Fla. Dist. Ct. App. 1978) (immunity from interference with access easement); *Breene v. Plaza Tower Ass'n*, 310 N.W.2d 730 (N.D. 1981) (immunity from leasing restriction). The term "fungible" is used here as Professor Radin employs it. *See Radin, supra* note 159.

220. Dr. Walker tells the story of a dog that was silenced when its owner acquired another dog to keep the first one company. She suggests fines on owners of troublesome animals (arguably a form of substitutionary relief for the POA) as an effective device for inducing the owners to solve the problem. Telephone Interview, *supra* note 97.

221. Arbitration rather than mediation would recreate the problem of quantifying the unit owner's loss. In this sphere, quantification is best performed by the parties themselves. An empirical study has revealed great owner receptivity to both arbitration and mediation of condominium disputes, with slightly higher receptivity to mediation. FLORIDA STUDY, *supra* note 12, at 63.

222. *See supra* note 153 and accompanying text.

holdouts, at least in some contexts. One study found that the Coase Theorem is substantially valid for groups of considerable size—that even under conditions of imperfect knowledge, efficient results are negotiated in groups of up to thirty-eight members more than ninety percent of the time.<sup>223</sup> This study suggests that negotiations may be feasible when there are thirty-eight or fewer dissident owners.

### VIII. CONCLUSION

Despite the courts' emphasis upon consent as the basis of POA decision-making power, empirical research and case fact patterns strongly suggest that POA decisionmaking can be coercive as well as consensual. To a considerable extent, the courts accurately assess this reality. The courts have forged rules of judicial review that reflect the interaction of empirical reality with certain liberal values. These values include individual preference, individual autonomy, and overall efficiency, at least to the extent that efficiency does not conflict with individual preference and autonomy.

When a complaining unit owner has approved an association decision by an act of effective consent, a court generally enforces the decision without inquiry into its reasonableness. When the complaining unit owner has not effectively consented, a court constructs a hypothetical bargain, that is, it substitutes the rules of constructive consent called reasonableness review. Reasonableness review is informed by the same efficiency, unanimity, and compensation principles that inform certain other areas of private law in situations in which genuine consent is not practicable.

A court denominates an association decision as reasonable if the decision is efficient and if it does not impose a net loss on the complaining unit owners. A decision is efficient if it creates greater utility gains than utility losses for the association membership in the aggregate. Courts calculate utility gains and losses by considering a wide range of financial and nonfinancial factors, including gains and losses of morale. A decision causes a net loss upon complaining unit owners if, immediately after the decision's enforcement, it inflicts upon those owners greater utility losses than utility gains. In the calculation of net loss and gain, the courts take into account the same factors that they employ in determining efficiency.

In some cases, primarily those involving common property and common finances, the courts tend to defer to an association's judgment of efficiency. In other cases, primarily those affecting individually owned units, the association carries the burden of persuading a court that it has acted efficiently. If a court

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223. See Hoffman & Spitzer, *Experimental Tests of the Coase Theorem with Large Bargaining Groups*, 15 J. LEGAL STUD. 149, 151 (1986): "Overall, 93 percent of the decisions were efficient and there was no deterioration as the bargaining groups got larger. If anything, efficiency improved with larger groups . . . . Virtually 100 percent of the full-information bargains were efficient, but efficiency was closer to 90 percent with limited information." The authors provide several implications from their results. One is that when a judge or a legislator is considering choosing a rule to govern a dispute in a situation in which there are as many as 38 parties, he "should assume that the parties can and will exhaust the gains from trade by voluntary agreement. One who would show that bargaining breakdown is likely must bear the burden of proof." *Id.*

finds that a decision is efficient but that the decision harms the complaining owners disproportionately, the court must determine whether those owners have suffered a net loss from the decision. If there is no net loss, the decision is reasonable. If there is a net loss, the decision is sustained only if adjustments can or have been made to preserve the decision's Pareto superiority. Those adjustments are effected by judicial construction and schemes of formal or informal compensation.

If the complaining owners have suffered net loss and the association has refused to compensate them or if compensation is impractical, then the court grants them immunity. Compensation is impractical when the decision creates significant loss of morale by irreparable interference with the complaining owners' personhood systems, usually by intruding into their territory or domestic lives.

The private law rules of judicial review have worked fairly well. They would work better if resort to them were more explicit. Courts, associations, and drafters need to establish more, and more formal, compensation arrangements. At this time, the only formal compensation arrangements widely institutionalized are association buyouts and rights of first refusal. Additional formal recognition of the compensation principle, together with institutionalized mechanisms for realizing that principle, would enable parties to attain the compensation ideal *ex ante* rather than *ex post* and would reduce the litigation burden that has debilitated so many associations and unit owners.