

## Memorandum 2010-45

**Common Interest Developments: Nonresidential Associations  
(Draft Tentative Recommendation)**

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This memorandum continues the Commission's study of the application of the Davis-Stirling Common Interest Development Act (Civ. Code §§ 1350-1378) (hereafter, "Davis-Stirling Act") to a nonresidential common interest development ("CID").

The Commission is nearing completion of a tentative recommendation in this study. It has already approved proposed legislation for use in the tentative recommendation. See Memorandum 2010-10; Minutes (Feb. 2010), pp. 6-7.

This memorandum presents a staff draft of the narrative "preliminary part" of a tentative recommendation, for the Commission's consideration and approval. The draft is included as an attachment to the memorandum.

The memorandum also discusses a small number of issues that should be resolved before the tentative recommendation is finalized. Some of those issues were raised at the August 2010 meeting, but decisions were deferred due to time constraints. See Memorandum 2010-37.

After reviewing the attached draft preliminary part and making decisions on the issues discussed in this memorandum, the Commission should decide whether to approve a tentative recommendation for public distribution.

All statutory references that follow are to sections of the Civil Code, unless otherwise noted.

## DEFERRED ISSUES

Consideration of the following issues, first raised in Memorandum 2010-37, was deferred by the Commission at the Commission's August meeting.

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Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website ([www.clrc.ca.gov](http://www.clrc.ca.gov)). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting.

### **Proposed Section 6600 (Conflicting Governing Document Provisions)**

One section in the proposed legislation in this study, Section 6600, would set forth a hierarchy of supremacy for the main documents that govern a CID — its declaration, articles of incorporation, bylaws, and operating rules — in order to resolve conflicts between provisions in those documents.

The Commission directed the staff to prepare language creating an exception to the regular hierarchy for a provision of the governing documents that is required by law.

In Memorandum 2010-48, the staff discusses adding a similar exception to an identical provision proposed for inclusion in a recodified Davis-Stirling Common Interest Development Act (“Davis-Stirling Act”). See Memorandum 2010-48, pp. 3-4.

**The staff recommends that the issue be treated the same way for both residential and nonresidential CIDs.** Whatever revision the Commission makes in connection with the recodification study should also be made in this study.

### **Proposed Section 6612 (Conflict with Applicable Law)**

The proposed legislation includes proposed Section 6612, which makes clear that an association’s governing documents are subordinate to controlling law:

6612. Notwithstanding a contrary provision of the governing documents, in the event of a conflict between a provision of a governing document and any provision of law, including, but not limited to, a statute, ordinance, regulation, building code, or court decision, the provision of law shall prevail.

In Memorandum 2010-48, the staff is recommending that the same issue be addressed in the recodification of the Davis-Stirling Act. However, the staff is recommending a different drafting approach. Rather than create a stand-alone section, the issue would be addressed in the section that sets out the hierarchy of supremacy for the main types of governing documents. See Memorandum 2010-48, pp. 3-4.

**If the Commission decides to adopt that approach, a parallel revision should be made in proposed Section 6600 and proposed Section 6612 should be deleted.**

### **Proposed Section 6870(d) (Construction Defect Litigation)**

At the February 2010 meeting, the Commission also directed the staff to revise proposed Section 6870(d), which is intended to continue existing Section 1375(d) without substantive change.

Section 1375 generally relates to construction defect litigation contemplated by an association. Section 1375(d) allows a prospective defendant in such litigation (the “respondent”) to request a pre-complaint “meet and confer” meeting with the board of directors of the association. A sentence in Section 1375(d) provides that this meeting “shall be subject to subdivision (b) of Section 1363.05,” a section of the Davis-Stirling Act generally governing board meetings in a CID.

Section 1363.05(b) provides as follows:

Any member of the association may attend meetings of the board of directors of the association, except when the board adjourns to executive session to consider litigation, matters relating to the formation of contracts with third parties, member discipline, personnel matters, or to meet with a member, upon the member’s request, regarding the member’s payment of assessments, as specified in Section 1367 or 1367.1. The board of directors of the association shall meet in executive session, if requested by a member who may be subject to a fine, penalty, or other form of discipline, and the member shall be entitled to attend the executive session.

As originally proposed by the staff, proposed Section 6870(d) would have replaced the existing cross-reference with the language shown in italics, below:

Within 25 days of the date the association serves the Notice of Commencement of Legal Proceedings, the respondent may request in writing to meet and confer with the board. Unless the respondent and the association otherwise agree, there shall be not more than one meeting, which shall take place no later than 10 days from the date of the respondent’s written request, at a mutually agreeable time and place. *Any member of the association may attend the meeting, except if the board adjourns to executive session.* The discussions at the meeting are privileged communications and are not admissible in evidence in any civil action, unless the association and the respondent consent in writing to their admission.

At the February 2010 meeting, concerns were raised about whether that language correctly captures the meaning of the existing cross-reference to Section 1363.05(b). See Minutes (February 2010), p. 7.

The issue is difficult because the proposed law would not continue the application of Section 1363.05 to a nonresidential CID. This means that the section cannot simply cross-refer to the provision that would continue Section 1363.05(b). Instead, the *substance* of the referenced provision must be restated in proposed Section 6870(d).

Section 1363.05(b) states the general rules for open and closed sessions in an association board meeting. Board meetings are open to the members, except as to matters that may (or must) be considered in closed session. A meeting to “consider litigation” may be closed. *Id.*

The meet and confer meeting authorized in Section 1375 would seem to fit within the scope of the litigation basis for a closed session. That interpretation is strengthened by the last sentence of Section 1375(d), which provides that discussions held in the meet and confer meeting are privileged. It would be unusual for discussions held in an open meeting to be considered privileged.

If this is correct, then the cross-reference to Section 1363.05(b) was probably intended to make clear that this meet and confer meeting may be conducted in a closed session. A leading CID treatise interprets the provision that way. See *Sproul and Rosenberry, Advising California Common Interest Communities*, § 10.71 (“[Section 1375(d)] meetings may be conducted in executive session, excluding the association’s members ...”).

Consistent with that reading of Section 1375(d), the staff recommends that **the cross-reference in proposed Section 6870(d) be revised to read as shown in italics below:**

(d) Within 25 days of the date the association serves the Notice of Commencement of Legal Proceedings, the respondent may request in writing to meet and confer with the board. Unless the respondent and the association otherwise agree, there shall be not more than one meeting, which shall take place no later than 10 days from the date of the respondent’s written request, at a mutually agreeable time and place. *The meeting may be conducted in executive session, excluding the association’s members.* The discussions at the meeting are privileged communications and are not admissible in evidence in any civil action, unless the association and the respondent consent in writing to their admission.

### **Nomenclature (“Nonresidential CID”)**

The proposed legislation would apply to “a common interest development that is *limited to industrial or commercial uses* by zoning or by a declaration of

covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located.” Sections 6506, 6556 (emphasis added). Existing Section 1373 has the same scope of application.

Although such CIDs could be described as “commercial or industrial CIDs,” in this study we have been referring to them as “nonresidential CIDs.”

As discussed in Memorandum 2010-37, we have received comments suggesting that a “nonresidential” CID need not be limited to commercial or industrial uses. It is possible that a CID may have no residences, but also have no commercial or industrial uses. For example, a CID could be comprised entirely of undeveloped land used for outdoor recreation purposes, with each owner having an exclusive right to use some designated space (e.g., a camping site) and a shared right to use the common area (e.g., a boat ramp, hiking trails, lake, etc.)

Because it is possible that a “nonresidential” CID might not satisfy the statutory criteria used in existing Section 1373 (and continued in the proposed law), it would probably be better to use a term that more closely matches the relevant legal criteria.

**The staff recommends using the term “commercial and industrial CIDs” (or, where grammar requires, “commercial or industrial CIDs”). The same change should be made in the proposed legislation. This is the approach taken in the attached draft of the preliminary part.**

This change in terminology would not have any substantive effect. But it would be more accurate and could help to avoid confusion about the intended scope of the proposed law.

#### **Civil Code Section 1366.4**

At the August 2009 meeting, the Commission made decisions regarding which provisions of the existing Davis-Stirling Act should apply to nonresidential CIDs. Memorandum 2009-32.

Since that time, a new provision has been added to the Davis-Stirling Act: Section 1366.4. See 2009 Cal. Stat. ch. 431.

Section 1366.4 relates to how the assessments of separate interests in a CID may be calculated. The section provides that, with limited exceptions, the amount of such an assessment may not be based on the taxable value of a separate interest.

The new provision was included in the proposed law as proposed Section 6806:

6806. (a) Except as provided in subdivision (b), notwithstanding any provision of this part or the governing documents to the contrary, an association shall not levy assessments on separate interests within the common interest development based on the taxable value of the separate interests unless the association, on or before December 31, 2009, in accordance with its governing documents, levied assessments on those separate interests based on their taxable value, as determined by the tax assessor of the county in which the separate interests are located.

(b) An association that is responsible for paying taxes on the separate interests within the common interest development may levy that portion of assessments on separate interests that is related to the payment of taxes based on the taxable value of the separate interest, as determined by the tax assessor.

The Commission now needs to make a policy decision on whether that provision should be applied to nonresidential CIDs.

#### *Review of Prior Methodology*

In determining which provisions of the Davis-Stirling Act should apply to nonresidential CIDs, the Commission first grouped all provisions of the Davis-Stirling Act into functional categories (e.g., establishment of a CID, meetings, notices, assessments, etc.). Memorandum 2009-32. The Commission then made decisions for each category of provisions, based on appropriate policy criteria. The Commission also considered input from several commenters, including relatively comprehensive comment from the stakeholder working group. See Memorandum 2009-32, Exhibit pp. 1-19.

This memorandum uses the same basic method in evaluating Section 1366.4.

#### *Whether Provision is Foundational or Operational*

One policy criteria applied by the Commission is whether the provision at issue is “foundational” or “operational.” Foundational provisions relate to the formation and basic character of CIDs. They define the CID form of property ownership. For the most part, they are necessary to the existence of a CID. By contrast, an operational provision specifies the manner in which the association’s governing association is to be operated. Such provisions address meeting procedures, voting, accounting, record-keeping, etc. See discussion in First

Supplement to Memorandum 2009-24. The distinction is also explained in the attached draft.

As a general matter, it seems clear that foundational provisions should be applied to all CIDs. They are necessary and are equally important for both residential and nonresidential communities.

It is less clear that any particular operational provision should apply to nonresidential CIDs. An operational provision may have been developed to assist or protect homeowners, with little regard for how it would affect sophisticated business property owners. As a general matter, operational provisions need to be examined, under other criteria, to determine whether they should apply to nonresidential CIDs.

It is unclear whether Section 1366.4 is a foundational provision. It does relate to one of the core financial concerns in a CID, the levying of assessments to fund the managing association and maintain common property.

However, it might have been enacted by the Legislature to ensure equity between homeowners, who might otherwise be assessed at widely different rates, despite the fact that they are receiving equivalent services. Such a protection might not be as necessary for business property owners, who can be expected to contract for whatever funding obligations suit their circumstances and needs. There is arguably less need for a statutory override in that context.

Although the question is relatively close, the staff suggests that Section 1366.4 appears to be at least *more* foundational than operational, as it relates to basic payment obligations of the owners and the total funding available to a CID, rather than the manner in which those funds are to be collected or disbursed. Consideration of this factor would therefore point, although perhaps not strongly, toward continued applicability to nonresidential CIDs.

#### *Exemption From Provisions Regulating Financial Management*

Another classification criterion previously applied by the Commission was general deference to business property owners on financial and accounting matters. While homeowners may require special protections to safeguard the uniquely important investment one has in one's home, it is less clear that businesses need to be safeguarded against making poor financial decisions. What's more, micromanagement of business financial matters could interfere unduly with a business' ability to make good planning decisions. See discussion in Memorandum 2009-24, pp. 13-16.

Because Section 1366.4 regulates financial arrangements within a CID, the criteria discussed here weighs in favor of nonresidential CIDs being exempted from the provision.

#### *Public Comment*

In addition to applying relevant policy criteria, the Commission has been very attentive to input from interested persons. The decisions made in the course of this study could have significant beneficial or deleterious effects when applied in practice. It is therefore important to solicit and consider stakeholder input.

At the August 2010 Commission meeting, the stakeholder working group advocated that nonresidential CIDs be exempted from Section 1366.4, but time constraints precluded discussion of the reasons for that preference.

No other commenter has expressed a position on whether Section 1366.4 should be applicable to nonresidential CIDs.

#### *Conclusion*

The staff is unsure how to treat Section 1366.4. The provision is not so foundational to the essential nature or operation of a CID as to be indispensable. However, the provision does touch on a core principle of the CID structure, shared obligation for common expenses.

**The staff invites further public comment on the issue from the stakeholder group or any other interested persons, which may help the Commission to resolve the matter.** If the Commission still cannot reach a clear decision, it may be easier to solicit comment on the provision if it is included in the proposed legislation, with a note specifically soliciting comment on whether it should be applicable to nonresidential CIDs.

### NEW ISSUES

#### **Application Language in Proposed Legislation**

The proposed legislation would amend existing Section 1373 to make the entirety of the Davis-Stirling Act inapplicable to specified commercial or industrial CIDs, and would create a new “Commercial or Industrial Common Interest Development Act” applicable to those same CIDs. In each instance, the legislation uses precisely the same language to describe the commercial or

industrial CIDs that would be affected, so as to prevent either a gap or an overlap in statutory coverage of commercial and industrial CIDs.

A simpler and more reliable way to provide for this same outcome would be to coordinate the two provisions by using a cross-reference, rather than reiteration of the standard. **The staff therefore recommends that Section 1373 be revised to cross-refer to the definition of “commercial or industrial common interest development” used in the proposed new statute, thus:**

1373. (a) This title does not apply to a commercial or industrial common interest development, as defined in Section 6556 ~~that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located.~~

### **Second Sentence of Section 1363(g)**

The first sentence of existing Section 1363(g) provides that an association that has adopted a policy of imposing monetary penalties on members for a violation of the CID’s governing documents must distribute a schedule of such penalties to the members.

The Commission previously decided that this mandate should continue to apply to commercial and industrial CIDs. Memorandum 2010-32, pp. 50-52; Minutes (Aug. 2009), p. 5. Despite the operational nature of the provision, the Commission concluded that the provision imposed minimal burden on CID operations, while providing a significant benefit.

The first sentence of Section 1363(g) has been continued in the proposed legislation as proposed Section 6850:

6850. If an association adopts or has adopted a policy imposing any monetary penalty, including any fee, on any association member for a violation of the governing documents, the board shall adopt and distribute to each member, by personal delivery or first-class mail, a schedule of the monetary penalties that may be assessed for those violations, which shall be in accordance with authorization for member discipline contained in the governing documents.

However, Section 1363(g) contains a second sentence that was *not* included in the proposed legislation:

The board of directors shall not be required to distribute any additional schedules of monetary penalties unless there are

changes from the schedule that was adopted and distributed to the members pursuant to this subdivision.

That sentence was omitted from proposed Section 6850, because the sentence was also omitted from the corresponding section in the proposed legislation prepared by the Commission in its CID recodification study.

In the recodification legislation, the sentence was discontinued because the required penalty schedule would be included in an annual policy statement that would be distributed to the members. However, the proposed legislation in this study does not require distribution of an annual policy statement. Consequently, the sentence of Section 1363(g) was not continued in this study at all.

That omission was inadvertent. It is therefore necessary for the Commission to make an independent determination of whether this second sentence of existing Section 1363(g) should be continued in the proposed legislation in this study.

To the extent it has any effect on the meaning of the first sentence, this second sentence appears to lessen any operational burden created by the first sentence of Section 1363(g). Its inclusion would therefore appear to be consistent with and further support the Commission's decision to retain the applicability to commercial or industrial CIDs of the first sentence of Section 1363(g).

The staff recommends that **the sentence be included in the proposed legislation, and that proposed Section 6850 be revised as follows:**

6850. If an association adopts or has adopted a policy imposing any monetary penalty, including any fee, on any association member for a violation of the governing documents, the board shall adopt and distribute to each member, by personal delivery or first-class mail, a schedule of the monetary penalties that may be assessed for those violations, which shall be in accordance with authorization for member discipline contained in the governing documents.

The board of directors shall not be required to distribute any additional schedules of monetary penalties unless there are changes from the schedule that was adopted and distributed to the members pursuant to this subdivision.

#### APPROVAL OF TENTATIVE RECOMMENDATION

A staff draft of the narrative "preliminary part" of a tentative recommendation in this study is attached to this memorandum and presented for the Commission's review and approval.

The draft provides an overview of the historical background underlying the Commission's recommendation to exempt exclusively commercial and industrial CIDs from several provisions of the existing Davis-Stirling Act, and explains the Commission's rationale for identifying those provisions that would no longer govern those CIDs. The draft further explains the benefit of implementing that recommendation by creating a new body of law, applicable only to those CIDs.

The draft also explains that the proposed new statute would be based on the organization and language of the proposed legislation in the Commission's ongoing CID recodification study. That approach would incorporate the drafting and organizational improvements developed in that other study and would also maximize the uniformity between the statutes governing residential and nonresidential CIDs.

The draft preliminary part specifically invites comment on whether any of the changes imported from the other study would be problematic if applied to a commercial or industrial CID.

**Does the Commission approve the draft preliminary part, with or without changes?**

### **Remaining Work**

Staff work remains to be done on the tentative recommendation, before it can be distributed for public comment.

The Commission has already approved proposed legislation to be included in the recommendation, based substantially on the language in the recodification legislation. See Memorandum 2010-10, pp. 3-4; Minutes (Feb. 2010), pp. 6-7. However, the Commission has approved a number of changes to the recodification legislation since making that decision. **The staff recommends that those recent changes also be incorporated into the proposed legislation in this study.**

It is very likely that further changes will be made to the recodification language, after circulation of a tentative recommendation in this study. Those changes should also be considered for incorporation into the nonresidential CID study. **That issue can be addressed in the process of reviewing public comments on the tentative recommendation.**

In addition, the staff will need to add "conforming revisions" to the proposed legislation, to correct cross-references to existing sections that would be included

in the proposed law. The preparation of those technical amendments should be fairly straightforward.

If the Commission is ready to approve a tentative recommendation at this time, there are two ways that the staff could handle the additional revisions discussed above:

- (1) Present the revised legislation for Commission approval at the December meeting, which would necessarily require postponing distribution of the tentative recommendation until after that meeting.
- (2) Present the revised legislation to the Commission's chair for review before the December meeting, and then circulate the tentative recommendation as soon as the revisions are approved.

**How would the Commission like to proceed?**

Respectfully submitted,

Steve Cohen  
Staff Counsel

# CALIFORNIA LAW REVISION COMMISSION

**STAFF DRAFT**

TENTATIVE RECOMMENDATION

## Commercial and Industrial Common Interest Developments

October 2010

The purpose of this tentative recommendation is to solicit public comment on the Commission's tentative conclusions. A comment submitted to the Commission will be part of the public record. The Commission may consider the comment at a public meeting when the Commission determines what, if any, recommendation it will make to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made to it.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN \_\_\_\_\_.

The Commission will often substantially revise a proposal in response to comment it receives. Thus, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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## SUMMARY OF TENTATIVE RECOMMENDATION

In 1988, the Legislature drew a statutory distinction between (1) residential common interest developments and (2) commercial and industrial common interest developments, declaring that statutes developed for the protection of residential developments may be unnecessary and unduly burdensome for commercial and industrial developments. Civil Code Section 1373 was enacted to exempt commercial and industrial developments from a number of such statutes.

In the 22 years since that enactment, the statutes governing common interest developments have more than tripled in size, without any comprehensive analysis of whether the added provisions should be applied to commercial and industrial developments.

The Law Revision Commission has conducted such an analysis and recommends the broad expansion of the policy expressed by the Legislature in 1988.

The proposed law would establish a separate statute governing commercial and industrial common interest developments, comprised only of those provisions that are necessary and appropriate for such developments.

This tentative recommendation was prepared pursuant to Resolution Chapter 98 of the Statutes of 2009.

## COMMERCIAL AND INDUSTRIAL COMMON INTEREST DEVELOPMENTS

### SUMMARY

1  
2 A common interest development (“CID”) is a real property development that  
3 includes all of the following: (1) separate ownership of a lot or unit, coupled with  
4 an undivided interest in common property, (2) covenants, conditions, and  
5 restrictions that limit use of both the common area and separate ownership  
6 interests, and (3) management of common property and enforcement of  
7 restrictions by a community association.<sup>1</sup>

8 The Davis-Stirling Common Interest Development Act (“Davis-Stirling Act”)<sup>2</sup>  
9 is the main body of statutory law that governs CIDs in California. The Davis-  
10 Stirling Act was enacted in 1985,<sup>3</sup> primarily to consolidate and standardize  
11 statutory provisions governing different types of CIDs.<sup>4</sup>

12 Shortly after enactment of the Davis-Stirling Act, concerns were expressed  
13 about the application of the Act to CIDs that are comprised entirely of commercial  
14 or industrial units, and do not contain any residences.<sup>5</sup> In response to those  
15 concerns, a bill was introduced to entirely exempt these nonresidential CIDs from  
16 the application of the Davis-Stirling Act.<sup>6</sup>

17 A building industry group suggested that the bill be amended to instead follow a  
18 more selective approach. While agreeing that the Davis-Stirling Act was  
19 “primarily ... enacted for the purpose of regulating residential developments,” the  
20 group argued that a number of the Act’s provisions were also necessary for  
21 commercial CIDs.<sup>7</sup> The bill was thereafter amended to add Civil Code Section  
22 1373 to the Davis-Stirling Act, and enacted.<sup>8</sup>

23 Section 1373 made several provisions of the Davis-Stirling Act inapplicable to  
24 commercial and industrial CIDs.<sup>9</sup> Section 1373 also included an explanatory  
25 statement of legislative findings:

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1. Civ. Code §§ 1352, 1363(a); C. Sproul & K. Rosenberry, *Advising California Common Interest Communities*, §§ 1.2, 1.14, 1.15, pp. 3-4, 15-19 (2010).

2. Civ. Code §§ 1350-1378.

3. 1985 Cal. Stat. ch. 874.

4. C. Sproul & K. Rosenberry, *Advising California Common Interest Communities*, § 1.4, pp. 5-6 (2010).

5. See letter from Jerold L. Miles to Michael Krisman (Sept. 16, 1986) (on file with Commission).

6. AB 2484 (Hauser) (1987).

7. See letter from Jeffrey G. Wagner to Assembly Member Daniel Hauser (June 12, 1987) (attached to Commission Staff Memorandum 2008-63 (Dec. 2, 2008), Exhibit pp. 1-2).

8. 1988 Cal. Stat. ch. 123.

9. Civ. Code § 1373(a). The provisions declared inapplicable were Civ. Code §§ 1356, 1363(b), 1365, 1365.5, 1366(b), 1366.1, and 1368. See 1988 Cal. Stat. ch. 123.

1 The Legislature finds that the [provisions declared inapplicable to commercial  
2 or industrial CIDs] may be appropriate to protect purchasers in residential  
3 common interest developments, however, the provisions are not necessary to  
4 protect purchasers in commercial or industrial developments since the application  
5 of those provisions results in unnecessary burdens and costs for these types of  
6 developments.<sup>10</sup>

7 In the 22 years since the enactment of Section 1373, the Davis-Stirling Act has  
8 more than tripled in size,<sup>11</sup> without any comprehensive analysis of whether the  
9 added provisions should apply to commercial and industrial CIDs.

10 The Commission has conducted such an analysis, and recommends that the  
11 legislative policies reflected in the enactment of Section 1373 be extrapolated to  
12 address subsequent changes in the Davis-Stirling Act.

13 This would be achieved by exempting commercial and industrial CIDs from the  
14 existing Davis-Stirling Act, and creating a new statute that would govern only  
15 those CIDs. The new statute would carry forward all Davis-Stirling Act provisions  
16 that should continue to apply to these nonresidential CIDs. However, provisions  
17 presently in the Davis-Stirling Act that “are not necessary to protect purchasers in  
18 commercial or industrial developments” and would “[result] in unnecessary  
19 burdens and costs for these types of developments”<sup>12</sup> would not be carried forward  
20 into the new body of law.

21 The establishment of a separate body of law for commercial and industrial CIDs  
22 would make it easier for the Legislature to tailor the future development of CID  
23 law so that it appropriately reflects important distinctions between residential and  
24 nonresidential CIDs.

#### 25 PRIOR LEGISLATIVE POLICY

26 Examination of the content of the Davis-Stirling Act at the time that Section  
27 1373 was added to that Act is helpful in understanding the legislative policy  
28 underlying the enactment of Section 1373. At that time, the Davis-Stirling Act  
29 consisted of only 25 sections, which mostly governed the establishment and basic  
30 structure of a CID, rather than mandating how a CID should conduct its daily  
31 affairs.

32 The provisions of the Act that continued to apply to a commercial or industrial  
33 CID after the enactment of Section 1373 included all of the following:

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10. Civ. Code § 1373(b).

11. The Act has grown from 25 code sections in 1986 (spanning 10 pages of the Deering's *Civil Practice Code*), to 89 code sections in 2010 (spanning 46 pages of the equivalent LexisNexis Standard California Codes).

12. Civ. Code § 1373(b).

- 1 • *Definitions and other general provisions.*<sup>13</sup> These provisions are necessary  
2 to the operation of the statute and the definition of the CID property  
3 ownership form, and impose no significant burden on the operation of a  
4 CID.
- 5 • *Governing document provisions.*<sup>14</sup> These provisions define the character of a  
6 CID's founding documents.
- 7 • *Property ownership and transfer provisions.*<sup>15</sup> These provisions provide  
8 special rules relevant to the CID form of property ownership.
- 9 • *Basic governance provisions.*<sup>16</sup> These provisions establish the basic  
10 governance structure for the management and maintenance of CID common  
11 area, and the enforcement of mutual restrictions. They enable governance,  
12 without regulating governance operations.

13 By preserving the application of those types of provisions, the Legislature seems  
14 to have concluded that such provisions are necessary for commercial and  
15 industrial CIDs and are not unduly burdensome to their operations.

16 Significantly, Section 1373 exempted commercial and industrial CIDs from the  
17 following types of provisions:

- 18 • *Provisions regulating fiscal planning and reporting.*<sup>17</sup> These provisions state  
19 mandatory requirements governing an association's fiscal planning and  
20 reporting.
- 21 • *Judicial override of supermajority amendment requirement.*<sup>18</sup> This provision  
22 authorizes a court to approve an amendment of a CID's declaration,  
23 notwithstanding a failure to satisfy a supermajority member approval  
24 requirement stated in the declaration.
- 25 • *Transfer disclosure requirements.*<sup>19</sup> This provision requires that specified  
26 information be provided to a prospective purchaser of a separate interest in a  
27 CID, before transfer of title.

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13. Civ. Code §§ 1350 (short title), 1351 (definitions), 1352 (application of Act).

14. Civ. Code §§ 1353 (content of declaration), 1354 (enforcement of restrictions as equitable servitudes), 1355 and 1357 (amendment of declaration).

15. Civ. Code §§ 1358 (transfer of separate interest), 1359 (partition), 1360 (separate interest improvements), 1361 (rights of ingress, egress, and support), 1362 (ownership of common area), 1369 (mechanics liens on common area), 1370 (liberal construction of title documents), 1371 (presumption regarding unit boundaries), 1372 (construction of local zoning ordinances).

16. Civ. Code §§ 1363(a) (existence and powers of association), 1364 (maintenance obligations), 1366(a) (authority to levy assessments), 1366(c) (authority to recover collection costs), 1366(d) (exemption from interest rate limitations), 1367 (authority to lien to collect overdue assessments).

17. Civ. Code §§ 1363(b) and 1365 (mandatory financial statement), 1365.5 (fiscal duties of board), 1366(b) and 1366.1 (limitations on assessment setting).

18. Civ. Code § 1356.

19. Civ. Code § 1368.

1 The exemption of commercial and industrial CIDs from those provisions  
2 indicates that the Legislature found them to be unnecessary and unduly  
3 burdensome for those types of CIDs.

4 The basis for these conclusions can be found in a legislative analysis of the bill  
5 that added Section 1373, which discussed the special character of commercial and  
6 industrial CIDs:

- 7 • Commercial and industrial CIDs are “business endeavors in which the  
8 parties engage the services of attorneys, accountants, management  
9 companies, and developers.”
- 10 • Unlike owners in residential CIDs, owners in commercial and industrial  
11 CIDs are “well-informed” and “governed by other provisions of commercial  
12 law.”
- 13 • “The operational needs of commercial and industrial CIDs are different than  
14 the needs of residential [CIDs].” For example, a commercial or industrial  
15 CID may require greater flexibility than a residential CID, in order to  
16 address significant business-related changes in the development’s use,  
17 facilities, and costs.
- 18 • Regulatory requirements designed to protect residential owners “interfere  
19 with commerce, and increase the costs of doing business.”<sup>20</sup>

20 Taken as a whole, the enactment of Section 1373 suggests the following policy  
21 principles:

- 22 • Provisions that define the basic property ownership and governance  
23 structure for CIDs are needed by commercial and industrial CIDs and do not  
24 unduly burden those CIDs.
- 25 • Provisions that are designed to help homeowners avoid mismanagement, by  
26 mandating specific management practices, are unnecessary and unduly  
27 burdensome for business owners in commercial and industrial CIDs.
- 28 • Provisions that are designed to help homeowners understand the  
29 consequences of purchasing a home in a CID are not needed by purchasers  
30 of units in commercial or industrial developments. Business owners  
31 purchasing commercial or industrial properties are presumably  
32 professionally advised and do not need the same statutory guidance  
33 appropriate for homeowners.
- 34 • A provision authorizing the court to circumvent a supermajority approval  
35 requirement for amendment of the declaration may be helpful in a  
36 residential CID, where homeowner apathy and fractiousness may make it  
37 difficult to obtain the approval required for a necessary amendment. By  
38 contrast, a business property owner may not need judicial intervention to  
39 resolve a dispute about amendment of the declaration. Furthermore, a  
40 business owner is likely to have read and relied on a CID’s governing  
41 documents before purchasing a unit in a commercial or industrial CID. A  
42 judicial override of the declaration could frustrate reasonable expectations.

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20. Senate Rules Committee Analysis of AB 2484 (May 18, 1988) (on file with Commission).

1 Section 1373 has been amended twice since its enactment. Both amendments are  
2 consistent with the principles set out above. They exempted commercial and  
3 industrial CIDs from provisions regulating governance operations:

- 4 • In 2003, Section 1373 was amended to exempt commercial and industrial  
5 CIDs from new statutory procedures for the adoption of operating rules.<sup>21</sup>
- 6 • In 2004, Section 1373 was amended to exempt commercial and industrial  
7 CIDs from new statutory procedures on architectural review  
8 decisionmaking.<sup>22</sup>

9 In summary, in enacting and amending Section 1373, the Legislature seems to  
10 have drawn a distinction between two broad classes of Davis-Stirling Act  
11 provisions:

- 12 • *Foundational Provisions.* These are provisions that address the fundamental  
13 character of the CID property ownership form. They include (1) definitions  
14 of key concepts, (2) provisions relating to a CID’s founding documents, (3)  
15 provisions on property ownership, transfer, and maintenance, and (4)  
16 provisions establishing the governing association and prescribing its  
17 necessary powers. Foundational provisions also include provisions  
18 necessary for the operation of the statute, such as rules of construction and  
19 technical definitions. These provisions are necessary for all CIDs and do not  
20 impose operational burdens on CIDs.
- 21 • *Operational Provisions.* These are provisions that impose mandatory  
22 procedures for the operation of a CID’s governing association. These  
23 provisions may assist and protect unsophisticated homeowners in managing  
24 their communities but are not needed by sophisticated commercial property  
25 owners. To the extent that they mandate “one-size-fits-all” management  
26 practices, they can unduly burden commercial and industrial CIDs.

## 27 RECOMMENDATION

28 The Commission recommends that the prior legislative policy judgments  
29 discussed above be continued and applied to the numerous provisions that have  
30 been added to the Davis-Stirling Act since 1988. The proposed law would do so  
31 by applying four broad principles:

- 32 • All foundational provisions should remain applicable to commercial and  
33 industrial CIDs.
- 34 • Most operational provisions should be made inapplicable to commercial and  
35 industrial CIDs.
- 36 • These policies should be effectuated by exempting commercial and  
37 industrial CIDs from the existing Davis-Stirling Act and creating a new  
38 statute to govern those CIDs.

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21. 2003 Cal. Stat. ch. 557.

22. 2004 Cal. Stat. ch. 346.

- No change should be made to the law governing residential CIDs.

The creation of separate statutes for residential and nonresidential CIDs would preclude the need for any future review and analysis of the type described here. Going forward, any CID reform would need to be made expressly applicable to commercial and industrial CIDs if it was to have that application. This would allow for the independent development of law governing the two distinct categories of CIDs, and would avoid the inadvertent application of residential CID reforms to nonresidential CIDs.

Exceptions to these general principles are discussed below.

#### **Special Notice Requirement**

Civil Code Section 1363(g) requires distribution of a schedule of monetary penalties that may be imposed as punishment for a violation of the governing documents. Although the provision could be characterized as operational, it seems appropriate as an element of a fair disciplinary procedure. The requirement does not appear to impose any significant burden on CID operation.

The Commission recommends that the proposed law include this provision.<sup>23</sup>

#### **Assessment Collection Provisions**

Civil Code Section 1367.1 contains a detailed procedural scheme for the collection of delinquent assessment payments. While the section relates to an operational aspect of CID governance, the Commission tentatively concluded that the well-developed procedure might prove useful, and not unduly burdensome, in a commercial or nonresidential CID.

With the exception of provisions requiring alternate dispute resolution, the Commission recommends that the provisions of Section 1367.1 be continued in the new statute.<sup>24</sup>

#### **Exemption from Constitutional Interest Rate Limitations**

Civil Code Section 1366(f) generally exempts CIDs from interest rate limitations imposed by Article XV of the California Constitution.

Although this provision could be characterized as operational, it does not appear to impose any burden on CID operations. To the extent that it facilitates assessment collection, it may provide a benefit to all CIDs, including commercial and industrial CIDs.

The Commission recommends that Section 1366(f) be continued in the new statute.<sup>25</sup>

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23. See proposed Civ. Code § 6850.

24. See proposed Civ. Code §§ 6808(a), 6810, 6812, 6814, 6816, 6818, 6820, 6822, 6824, and 6826.

25. See proposed Civ. Code § 6808(b).

1 **Construction Litigation Provisions**

2 Four sections of the Davis-Stirling Act govern construction defect litigation in a  
3 CID.<sup>26</sup> Although they might be described as operational provisions, the  
4 Commission recommends that they be preserved. The well-developed procedures  
5 provided in those sections relate to a dispute between an association and a builder,  
6 a third party who is not involved in CID governance. Those provisions appear to  
7 be equally appropriate for the resolution of such disputes in any type of CID.<sup>27</sup>

8 **OVERVIEW OF PROPOSED LEGISLATION**

9 **Application of Proposed Law**

10 The proposed law would only apply to an exclusively commercial or industrial  
11 CID.<sup>28</sup> The application of the proposed law would be defined using the same  
12 language that is used to define the scope of existing Civil Code Section 1373,  
13 which applies to:

14 [a] common interest development that is limited to industrial or commercial  
15 uses by zoning or by a declaration of covenants, conditions, and restrictions that  
16 has been recorded in the official records of each county in which the common  
17 interest development is located.<sup>29</sup>

18 **Source of Statutory Language and Organization**

19 The purpose of the proposed law is to establish a new statute governing  
20 commercial and industrial CIDs, which would include only those provisions that  
21 are necessary for such CIDs and are not unduly burdensome to their operations.  
22 One way this could be accomplished would be by copying the exact language and  
23 organization of the existing Davis-Stirling Act provisions that are to be included in  
24 the proposed law.

25 The proposed law would take a different approach. It would instead incorporate  
26 statutory language and organization that has been developed as part of a pending  
27 Law Revision Commission proposal to simplify and reorganize the existing Davis-  
28 Stirling Act, to make it easier to use and understand.<sup>30</sup> That proposal is a mostly  
29 nonsubstantive cleanup project, though it does include some noncontroversial  
30 substantive improvements as well. It is expected that the proposed recodification  
31 of the Davis-Stirling Act will be presented to the Legislature for consideration  
32 prior to completion of work on the current study.

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26. Civil Code §§ 1368.5, 1375, 1375.05, and 1375.1.

27. See proposed Civ. Code §§ 6870, 6872, 6874, and 6876.

28. See proposed Section 6506.

29. See proposed Section 6556.

30. See tentative recommendation on *Statutory Clarification and Simplification of CID Law* (Feb. 2010).

1 By incorporating the language and structure of the proposed recodification of  
2 the Davis-Stirling Act, the proposed law will include the benefits of improvements  
3 made in that separate study. This approach will also maximize the uniformity of  
4 language and structure between the law governing residential and nonresidential  
5 CIDs.

6 Any changes to existing law proposed in the recodification proposal are also  
7 included in the proposed law. Sections containing such changes will have the  
8 words “NEW” or “REVISED” in their headings. All changes are noted and  
9 described in the Comments and Notes following the new or revised provisions.

10 **The Commission specifically invites comment on whether any of those**  
11 **changes would be problematic if applied to a commercial or industrial CID.**

12 If further changes are made to the Commission’s recodification proposal before  
13 it is finalized, those changes will also be considered for incorporation into the  
14 proposed statute on commercial and industrial CIDs.

15 **Disposition Table**

16 A “disposition table” following the proposed law shows the relationship  
17 between the existing provisions of the Davis-Stirling Act and the provisions of the  
18 proposed law. This table also identifies the provisions of the Davis-Stirling Act  
19 that have not been included in the proposed law, by an indication that those  
20 provisions are “not continued.”

21 **Conforming Revisions**

22 There are a number of code sections that include a cross-reference to a provision  
23 of the Davis-Stirling Act. To the extent that such a reference is relevant to  
24 commercial and industrial CIDs, it will need to be revised to include a reference to  
25 the corresponding provision of the proposed law.<sup>31</sup> Amendments to accomplish  
26 this are included in the “Conforming Revisions” portion of the proposed law.

27 **REQUEST FOR COMMENT**

28 The Commission requests that interested persons and groups carefully review  
29 the proposed legislation and submit comments on both the inclusion and exclusion  
30 of Davis-Stirling Act provisions, as well as the proposed substantive  
31 improvements.

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31. Not all references to a provision of the Davis-Stirling Act will need to be adjusted. For example, some references are specifically limited to residential developments and so have no relevance to a commercial or industrial CID. See, e.g., Bus. & Prof. Code § 10131.01. The cross-references in such provisions would not be revised.