Study H-851 May 4, 2001

Memorandum 2001-42

Nonjudicial Dispute Resolution Under CID Law: General Approach

This memorandum presents materials relating to the general approach being taken by the Commission on nonjudicial dispute resolution under common interest development law. Attached to this memorandum is the following letter:

BACKGROUND

At its March 2001 meeting the Commission decided to explore whether existing mechanisms and entities could be used more effectively to provide nonjudicial dispute resolution techniques for common interest development disputes.

The Commission also felt it would be useful to bear in mind that different types of disputes may be better handled by one technique than another — one size does not necessarily fit all. For example, mediation may be inappropriate where one of the parties enters mediation without the intention of settling, or where the issue transcends the interests of the individual homeowner and affects the community generally, such as the appropriate level of maintenance assessments for the community.

Specific matters the Commission will investigate include:

Categorization of Disputes

The Commission will consider ways of distinguishing among the cases in which mediation and other dispute resolution processes would be beneficial. This might involve categorization of disputes by type or subject matter. It could involve a process for evaluating and directing individual disputes to an appropriate resolution mechanism.

Stepped Approach

The Commission will consider the possibility of some sort of stepped approach to resolving disputes. For example, a med-arb option could help to

efficiently dispose of a dispute by converting a mediation into an arbitration without loss of the time or money already invested in the dispute resolution process, in cases where it becomes apparent that mediation is not going to work. In such a sequence, arbitration probably should be binding. But to ensure fairness, there would need to be an appropriate level of judicial review of the arbitrator's decision.

Jurisdiction of Small Claims Court

The Commission will investigate possible expansion of small claims court jurisdiction. This could offer the opportunity for a relatively quick and neutral decision in an accessible and lawyer-free environment, at least with respect to some types of disputes.

Due Process in Decisionmaking

Some of the association actions that may generate disputes are quasi-governmental in nature, where the association is in effect assuming functions that a local public entity might traditionally have performed. For these sorts of functions, procedures might be imposed that are analogous to those used in the public arena, including due process and majority control. By parity of reasoning, however, once basic procedural protections have been satisfied, judicial review would be limited, as it is for comparable public entity decisions.

In this connection the Commission will consider the possibility of imposing some sort of personal responsibility on directors who violate basic due process requirements in the governance of an association. Such a sanction would need to be carefully considered so as not to create a further disincentive for homeowners volunteering to serve on boards. A sanction against a management intermediary that advises the board might also be an option.

Role of Attorney General

With respect to association governance issues, such as meetings, notices, elections, etc., that come within the ambit of the Nonprofit Mutual Benefit Corporation Law, the Commission will investigate the Attorney General's role. It is possible that invigorating the operations of the Attorney General in this area could be helpful, either in resolving disputes or in providing a contact point for people who need information.

Information Center

The Attorney General could provide the function of informing people about the governing law and about the availability of alternative dispute resolution processes. Other possibilities for this function could include the Department of Fair Housing or decentralized county offices. In any event, the Commission will consider creating a clear contact point for information, perhaps with an associated website or other means of getting information to people readily and inexpensively. The information should include a plain English description of options that are available and contact information that will direct people where to go in order to take advantage of a particular option.

COMMENTS ON GENERAL APPROACH

We have received a letter from Marjorie Murray, attached as an Exhibit, that offers comments on the general approach to nonjudicial dispute resolution under common interest development law. Her proposals relate to prevention of disputes, financing of ADR programs, and use or enhancement of existing community and governmental resources. As such, they are generally consistent with the approach adopted by the Commission.

Specific suggestions include:

(1) Finance dispute resolution procedures by assessing a small annual parcel tax, by imposing penalties for late filing of corporate documents, and by using Community Development Block Grant money.

(2) Require continuing education for association directors concerning their legal and fiscal responsibilities, conducted by a fair housing organization.

(3) Limit the availability of insurance coverage of association directors for breach of legal and fiduciary duties in some instances.

(4) Require governing documents to be in plain English and provided to the homeowner other than at close of escrow, along with information about obtaining help.

(5) Require that assessment disputes be handled in small claims court.

(6) Use Conciliation Forums to mediate homeowner v. association disputes.

(7) Use Attorney General's powers to help resolve disputes.

(8) Provide the homeowner access to an advocate for help in arbitration and other dispute resolution procedures.

(9) Recognize CIDs as quasi-governmental entities, subject to the same constraints as local government with respect to open meeting laws, public records, term limits, conflict of interest limitations, etc.

SCHEDULING MATTERS

The Commission has decided to give nonjudicial dispute resolution a priority in the Common Interest Development study. The staff plans to present material regularly on this matter at Commission meetings.

However, this project will have to proceed at a relatively low level and slow pace at least for the remainder of 2001. Most of the Commission's staff resources are being diverted to the massive project on trial court restructuring (repeal of statutes made obsolete by trial court funding, unification, and employment reforms), due January 1, 2002.

We have commenced with analyses of small claims court jurisdiction (Memorandum 2001-43) and the role of the Attorney General (Memorandum 2001-44), scheduled for consideration at the Commission's May meeting. Where we go from there will depend in part on what actions the Commission takes on those matters.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

May 4, 2001

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Dear Mr. Sterling:

This letter lays out some preliminary thoughts on the Commission's goal of finding ways to resolve disputes between homeowners and CID associations. There are no silver bullets here.

These proposals draw on my own experience as a property owner in a rural water association and as a former board director. I am also drawing on my firsthand experience in trying to help two homeowners fend off foreclosure actions by Snowshoe Springs Association. I have thought long and hard about

- how the "dispute" [battle?] between Mr. Donnell and the Association could have been prevented.
- Once it escalated, how could it have been resolved without the courts.

Please keep in mind that I am speaking from a particular point of view: as a part-time resident in a rural water association in a rural county. However, I do think that some of my ideas apply as well to the full-time resident in an urban association.

This memo focuses on

- Prevention of disputes through
  - continuing education/certification of lay boards and property owners
  - penalties to be imposed by insurance companies on lay boards refusing to comply with governing documents.
- Financing of ADR
- Use/enhancement of existing community and governmental resources

Any system for helping the beleaguered property owner must

- Include help for board directors working to prevent disputes
- Be promulgated and managed by an entity outside the association and NOT tied to the association industry.
- Equalize the balance of power between property owner and association
- Be readily accessible and easy to use

A more radical point: I hope that, during its study of CID law, the CLRC will reassess the true nature of property owner associations. Are these truly private corporations? Or are they quasi-governmental entities masquerading as private companies shielded by the California corporations code?

I. Financing of Non-judicial Dispute Resolution

- With the $1-2 annual tax per property owner proposed in your last memo to the CLRC. Ordinarily I wouldn't propose taxing myself; however, two months ago the Snowshoe board has raised our annual dues $40. Nearly half of that amount -- $17 -- (by the board's admission) is to go to attorney's fees, because the board says it expects to get sued over the foreclosures. I'd rather pay a $1-2 a year tax to finance a workable dispute resolution system than $17 a year for attorney's fees – an attorney who has a vested interest in keeping the dispute alive.

- With monetary penalties imposed by the Secretary of State on associations which file late or fail to file at all their annual incorporation statement. [See below]

- With Community Development Block Grant money.

II. Prevention of Disputes

How can we prevent disputes from arising in the first place? Boards and property owners alike need continuing education in both their rights and their responsibilities, though boards need it more, since they are the ones exercising all the power. These rights and responsibilities are, presumably, contained in the association's governing documents. How do boards and homeowners get these documents? Do they understand what's in them?

Potential Role of the California Secretary of State's Office in Financing ADR and in Certifying Boards

- A property owners' corporation is required to file an annual incorporation statement with the secretary of state indicating that the corporation is still active. I believe there's a nominal fee attached to filing, but there are no penalties (that I know of) imposed on a board for not filing. [Snowshoe rarely complies with this requirement.] Imposing penalties for late filing or failing to file could be a source of money for any new dispute resolution program the CLRC proposes.

- When an association files its annual statement, it could also file a statement that its board has completed a continuing education program in its legal and fiscal responsibilities as corporation directors. Filing this certification would be a requirement for keeping its corporate status active.

Why do I propose this?

By year's end, Snowshoe – as a Mutual Benefit Water Company – is going to have to comply with new state laws [Dept. of Health Services and the state Water Resource's board] requiring that it have a professionally certified operator in charge of the water system. The certificate requires annual continuing education. It requires that Snowshoe pay a fee.

If Snowshoe has to get certification to operate its water system, then its board should be able to demonstrate each year that it is trained to handle the legal responsibilities of running the corporation entrusted with the water system.

- Who would do the training? Whoever it is, it should be a disinterested party, i.e. an entity not tied to the homeowner association industry: none of its lawyers or management companies, etc. I would propose that a non-profit Fair Housing organization do it, perhaps with monies accrued from the secretary of state filings or from the payment of a new certification fee. In our case, the California Rural Legal Assistance, which serves the rural counties, might be a candidate for doing the training.

- Is there federal Block Grant money (funneled to California),which could be set aside for training the boards of CIDs? This would be a pot of money for which Fair Housing groups could compete to do the training.

- There are other nonprofit groups that already do standard board training, e.g. the Support Center in San Francisco. Training for homeowner boards could be grafted onto the work that groups like the Support Center already do.

Potential Role of Insurance Companies in Preventing Disputes: Removing the Errors and Omissions Shield

Every association board – including ours – carries errors and omissions insurance. Directors shield themselves with E&O insurance, figuring that if a homeowner challenges them – or sues them – that E&O will protect the association and themselves as individuals from liability. This shield allows directors to act with impunity.

I would propose, however, once a board member has taken the required training described above, but still fails to implement his/her legal duties as spelled out in the governing documents, then the E&O insurance would not protect the director.

I would think the insurance companies would be glad not to have to pay out for the intentionally wrong behavior of directors. On the other hand, I think they would welcome having a board trained in its legal and fiduciary duties.

Maybe director training should be a requirement of getting E&O insurance renewed. What would the insurance industry think of this?

Prevention of Disputes by Informing the Homeowner of His Rights

Homeowners are poorly-informed about their rights, mostly because information comes to them – if at all – from directors and industry professionals who have a vested interest in hoarding the information. Many of these rights are contained in the association's governing documents. I propose that

- Governing documents be written in plain English so that they're understandable. [This is a long-term goal.]
- Governing documents be sent to the property owner by the secretary of state [articles and bylaws] and the county in which they're recorded [CC&Rs] and not given to the property owner at the close of escrow [when the property owner gets an overwhelming number of indecipherable legal documents.] A cover letter from the county and from the secretary of state will indicate the nature of each document.
- There be a phone number – secretary of state? The county? Department of Real Estate? – that the homeowner can call to get a document deciphered [since the chances of it being written in plain English are remote.]
- That property owners be sent an annual statement – from the county, from the Secretary of State, from the Department of Real Estate – describing where the property owner can go for help.

III. Use of Existing Governmental/Community Resources

- Small Claims court. All homeowner assessment disputes should go to small claims. In California the claim limit is $5000. If the association has let the figure get higher than $5000, then there is something wrong with the directors' management of the association.
- Potential Role of the Secretary of State: outlined above
- Mediation Services: e.g. Conciliation Forums in Oakland, which works in conjunction with nonprofit Fair Housing groups to negotiate/mediate landlord/tenant disputes. This same model could be replicated to resolve property owner/association disputes.

- State Attorney General's Office. Though I have been a board director for several years, I did not know about the role of the AG's office until I read the March 7 CLRC staff report. As a director working to resolve the dispute between Mr. Donnell and the Snowshoe association, I would have appreciated having an ally. Would the AG's office be a candidate for this role?

IV. Equalizing the Balance of Power: Property Owner Access to an Advocate

Whatever dispute resolution system gets put in place, it will be crucial for the property owner to have access to an advocate. I am thinking, again, of Mr. Donnell.

Sending frail Mr. Donnell in to an arbitration session against the association would be like putting him in the boxing ring against Muhammed Ali. On one side of the table would be the association with a pocketful of money, its Sacramento attorney to coach it beforehand, its access to all the association records, prior experience dealing with homeowners challenging its authority, and the personal and professional expertise of individual board members in preparing a "case."

Mr. Donnell -- assuming he wasn't in the hospital -- would bring none of these resources to the arbitration session. He would need ready access to a housing advocate – someone from Fair Housing, e.g. – with skills and experience in arbitration.

V. CID as Corporation or as Quasi-Governmental Entity: Animal, Vegetable, or Mineral?

I hope at some point in its study of CID law, that the CLRC assesses the true nature of the California property owners' association. Is it truly a private corporation? Or is it a quasi-governmental entity shielded by the California corporations code.

Many associations – especially in the rural counties like Calaveras – function as substitutes for local governments. Calaveras welcomes associations like Snowshoe, whose 1500 or so property owners pay fulltime taxes, but make few demands on county services. We make marginal use of the schools, public works, the courts, the electoral machinery, or the planning department for example. We are a self-contained little "city", providing our own water, running our own elections, governing our own affairs.

Unlike a local government, however, there are none of the usual restraints on public officials, e.g. open meeting laws, public records act, term limits, filing of conflict-of-interest statements by its directors – and by its vendors, etc. To the extent that any comparable restraints are imposed by the Corporations code, again, there are no penalties for complying with the code provisions. I wonder how many disputes might be prevented

if associations were recognized legally as quasi-governmental entities subject to the same restraints as other local governments.

I hope the CLRC looks at this very essential question.

Sincerely,

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