

Memorandum 2001-44

Nonjudicial Dispute Resolution Under CID Law: Role of Attorney General

The Commission has requested further information regarding the role of the Attorney General in overseeing the governance of a common interest development by a homeowners association. Under Corporations Code Section 8216, the Attorney General has authority to oversee some aspects of the governance of nonprofit mutual benefit corporations. The nature of this oversight authority under existing law, and possible ways to invigorate its exercise, are discussed below. Except as otherwise indicated, all statutory references below are to the Corporations Code. Section 8216 is attached as an exhibit.

APPLICABILITY TO HOMEOWNERS ASSOCIATION

Section 8216 is part of the Nonprofit Mutual Benefit Corporation Law and applies to corporations organized under that law. An association organized to govern a common interest development (“homeowners association”) may be incorporated or unincorporated. Civ. Code § 1363(a). Most homeowners associations are incorporated as nonprofit mutual benefit corporations and are subject to the law governing such corporations. See C. Sproul & K. Rosenberry, *Advising California Condominium & Homeowners Associations* § 1.9 (Cal. Cont. Ed. Bar 2001). Thus, an incorporated homeowners association, like any other mutual benefit corporation, is subject to oversight under Section 8216.

An unincorporated homeowners association is obviously not a “corporation” and therefore appears, at first glance, not to be subject to oversight under Section 8216, which governs “corporations.” However, there are some parts of the Corporations Code that apply to homeowners associations regardless of whether they are incorporated. For example, Civ. Code § 1363(c) provides that an unincorporated homeowners association may exercise many of the powers of a mutual benefit corporation. However, this grant of powers does not subject an unincorporated homeowners association to any of the provisions that are subject to oversight under Section 8216.

There are three provisions of the Davis-Stirling Common Interest Development Act that specifically incorporate Corporations Code provisions that are subject to Attorney General oversight under Section 8216:

- Civil Code Section 1355.5 provides for amendment of an association's governing documents to delete provisions relating to construction and marketing, once development is complete. The amendment cannot be made without a meeting and vote of the membership. The meeting and vote are subject to the rules governing meetings of a mutual benefit corporation (§§ 7510-7527).
- Civil Code Section 1363(f) provides that a member has a right to inspect association records in accordance with the rules governing member access to records of a mutual benefit corporation (§§ 8330-8338).
- Civil Code Section 1366 limits increases in annual assessments, absent approval of at least half of the membership in a meeting or election. These meetings and elections are subject to rules governing meetings of a mutual benefit corporation (§§ 7510-7527, 7613).

In these specific areas, the Attorney General may have oversight authority over an unincorporated association (depending on how strictly one construes the term "corporation" in reading Section 8216). If the Commission decides that Attorney General oversight of an unincorporated association is appropriate in these areas, the law could be made clearer by adding a subdivision to Section 8216 along the following lines:

(c) For the purposes of this section, "corporation" includes an unincorporated association managing a common interest development, to the extent that the association is subject to this chapter, Chapter 5 (commencing with Section 7510), Chapter 6 (commencing with Section 7610), and Chapter 13 (commencing with Section 8310).

Comment. Section 8216 is amended to make clear that it applies to an unincorporated homeowners association to the extent that the association is subject to specified provisions of this part. See, e.g., Civ. Code §§ 1355.5(d) (incorporating Sections 7510 to 7527), 1363(f) (incorporating Sections 8330 to 8338), 1366(a)-(b) (incorporating Sections 7510 to 7527, and 7613).

Note: because the Davis-Stirling Act incorporates only specific parts of the Corporations Code, one could perhaps infer that other parts of the Corporations Code do not apply to a homeowners association, *even if the homeowners association*

is incorporated. Obviously, the Corporations Code does not generally apply to an unincorporated homeowners association. However, it seems clear that a homeowners association organized as a mutual benefit corporation is subject to those provisions of the Corporations Code that are applicable to a mutual benefit corporation. The Nonprofit Mutual Benefit Corporations Law, and portions of the Nonprofit Corporation Law apply by their own terms to any entity organized as a mutual benefit corporation. See §§ 5003(a), 5046(c), 5059. There is also case law applying the Nonprofit Mutual Benefit Corporations Law to a homeowners association that is organized as a mutual benefit corporation. See, e.g., *ECC Construction, Inc. v. Ganson*, 82 Cal. App. 4th 572, 575-76 (2000) (homeowners association incorporated as mutual benefit corporation subject to Section 7350, relating to member liability). The staff could find no case law or other authority to the contrary.

NATURE OF OVERSIGHT

Section 8216 authorizes the Attorney General to act on behalf of a member, director, or officer of a mutual benefit corporation who complains about a failure of the corporation to comply with specified provisions of the Corporations Code (discussed below). The Attorney General may send “notice of the complaint” to the corporation. If the corporation does not respond within 30 days, or if its response is unsatisfactory, the Attorney General may

institute, maintain or intervene in such suits, actions, or proceedings of any type in any court or tribunal of competent jurisdiction or before any administrative agency for such relief by way of injunction, the dissolution of entities, the appointment of receivers, or any other temporary, preliminary, provision or final remedies as may be appropriate to protect the rights of members or to undo the consequences of failure to comply with such requirements.

Thus, the Attorney General has very broad authority to intervene in a dispute between a mutual benefit corporation and its members, but is not required to do so.

SCOPE OF OVERSIGHT

Section 8216 authorizes the Attorney General to respond to complaints regarding a mutual benefit corporation’s failure to comply with specified

statutory requirements regarding meetings, elections, document filing, record-keeping, and access to records. Some of the provisions subject to oversight under Section 8216 provide default rules that can be overridden by a corporation's governing documents (e.g., Section 7512(a) provides that one-third of the voting power of a corporation constitutes a quorum at a meeting of members, unless the corporation's by-laws specify a different quorum). Where the Corporations Code establishes a default rule and allows for variation in a governing instrument, the Attorney General's oversight appears to include oversight of whether the corporation has complied with its own governing instrument.

The specific provisions subject to oversight under Section 8216 are briefly described below.

Meetings and Alternatives to Meetings

Section 8216 provides for oversight of compliance with Sections 7510 to 7527, which relate to meetings and alternatives to meetings. More specifically, the sections govern the following:

- When and where member meetings must be held (§ 7510).
- Meeting notice requirements (§ 7511).
- Quorum requirements (§ 7512).
- Member ballots in lieu of a meeting (§ 7513).
- Form of ballots (§ 7514).
- Court-authorized deviation from meeting requirements (§ 7515).
- Unanimous written consent in lieu of a meeting (§ 7516).
- Validity of ballots and proxies (§ 7517).

Elections

Section 8216 provides for oversight of compliance with Sections 7520 to 7616, which relate to elections. More specifically, the sections govern the following:

- Procedures for nomination and election of directors by members (§§ 7520-7522).
- Use of corporate resources to support a candidate (§§ 7253-7526).
- Limitation of an action to challenge the validity of the election, appointment, or removal of a director (§ 7527).
- Member voting rights (§ 7610-7611).
- Voting of joint memberships (§ 7612).
- Proxies (§ 7613).

- Election inspectors (§ 7614).
- Cumulative voting (§ 7615).
- Judicial determination of the validity of a contested election (§ 7616).

Filings

Section 8216 provides for oversight of compliance with Sections 8210 to 8217, which relate to required filings and record-keeping. More specifically, the sections govern the following:

- Filing of a statement of the names and addresses of corporate officers and of an agent for the service of process (§ 8210).
- Loss and replacement of an agent for the service of process (§§ 8211-8212).
- Access to property records for the purpose of local assessment (§ 8214).
- Liability of officers and directors for falsification or tampering with records (§ 8215).

Records

Section 8216 provides for oversight of compliance with Sections 8310 to 8338, which relate to record-keeping and access to records. More specifically, the sections govern:

- General rules for inspection of records (§§ 8310-8313).
- Types of books and reports a corporation must prepare and maintain — including records of account, minutes, membership lists, annual reports to members, lists of any assets held in charitable trusts, and the results of membership votes (§§ 8320-8322, 8324-8325).
- Judicial enforcement of reporting requirements (§ 8323).
- Inspection of membership records (§§ 8330-8332, 8338).
- Member's right to inspect accounting records and minutes (§ 8333).
- Director's right to inspect records (§ 8334).
- Enforcement of right to inspect records (§§ 8335-8337).

PROBLEMS WITH SCOPE OF OVERSIGHT

The scope of oversight under Section 8216 poses two problems: (1) it is limited to governance matters and may not be helpful in resolving more substantive disputes. (2) The oversight authority does not apply to governance procedures specified in the Davis-Stirling Act. These problems are discussed below.

Limitation to Governance Procedures

Section 8216 provides oversight of compliance with governance procedures (providing required notices, holding required meetings, allowing inspection of records, etc.). This oversight is important as it provides a means of policing the operation of a homeowners association. Also, many disputes between homeowners and their associations may involve unfair and illegal procedures. Correction of procedural problems may be a first step toward remedying a substantive problem.

On the other hand, many substantive problems may have little or nothing to do with procedural violations. In Memorandum 2001-31, the staff described the nature of most disputes between homeowners and their associations:

We understand that association-homeowner disputes typically fall into one of several categories:

- (1) Financial disputes (maintenance, common charges, special assessments, fines and penalties, restrictions on resale or transfer, access to books and records).
- (2) Architectural controls (repairs, alterations, painting, decor, landscaping).
- (3) Pet issues (barking dogs, wandering cats, animal waste).
- (4) Use of private space (leasing/subleasing, commercial or professional use).
- (5) Personal interactions (facilities use, parking, noise, rudeness).

In many cases, Section 8216 would not address the substantive issues involved in such disputes.

Governance Provisions of Davis-Stirling Act

The Davis-Stirling Act includes a number of governance provisions. For example, Civil Code Section 1363.05, the “Common Interest Development Open Meeting Act,” specifies rules governing meetings of a homeowners association. Some provisions of Section 1363.05 address issues not covered by the

Corporations Code (e.g., subdivision (i) concerns the right of a member to speak at a meeting). Other provisions address matters covered by the Corporations Code, but provide different rules (e.g., subdivision (g) requires that notice of a meeting be given at least four days before the meeting, while Section 7511 requires at least 10 days notice).

Where a provision of the Davis-Stirling Act provides a governance rule that is not also addressed by the Corporations Code (e.g., the right to speak), that rule is apparently not subject to oversight under Section 8216. Where the Davis-Stirling Act provides a rule that is different from a rule provided in the Corporations Code, the outcome is less clear. Does the four day notice requirement in Civil Code Section 1363.05(g) supersede the 10 day notice requirement in Section 7511? If so, does Section 8216 authorize oversight of a failure to provide advance notice of a meeting? If the issue is one of compliance with Civil Code Section 1363.05(g), then probably not.

One of the suggestions made by Professor French in her background study, was that the “the interrelationship among the governing documents, the CID Act and the Corporations Code should be reviewed for suitability and compatibility, and also to ensure that it is clear which provision prevails in the event of conflict.” Once this is accomplished, it may be appropriate to amend Section 8216 so that it provides for oversight of compliance with the governance provisions of the Davis-Stirling Act, as well as the specified governance provisions of the Corporations Code.

PRACTICAL LIMITS ON EXERCISE OF OVERSIGHT

The Attorney General’s oversight authority under Section 8216 is discretionary. According to a letter from the Attorney General to Frederick L. Pilot of the Common Interest Consumer project (attached):

It is the long standing policy of the Attorney General’s office to exercise our discretionary authority established in Corporations Code § 8216 by providing a public service to members of non-profit mutual benefit corporations who complain to us in writing that their rights, as enumerated in that body of law, have been violated. Our involvement takes the form of sending a “notice of complaint” letter to the board of directors of the corporation. In many instances, our “notice” letter is effective in resolving the complaint or at least encouraging a board to review its procedures in relationship to the law. However, complainants whose disputes are

not resolved as a result of our informal intervention are directed to seek private civil remedies if they wish to continue to pursue the matter. Government cannot be expected to resolve all civil disputes at taxpayers' expense as the costs of litigation and the required bureaucracy are prohibitive.

The staff has confirmed, in communications with the Attorney General's office, that this is still the policy regarding Section 8216.

It is worth noting that provisions similar to Section 8216 provide for Attorney General oversight of the governance of other types of business organization as well. See §§ 1508 (general corporation), 6216 (public benefit corporation), 12576 (consumer cooperative corporation), 15532 & 15635 (limited partnership), 17107 (limited liability company). Apparently, the same policy applies to implementation of these oversight provisions — complaint letters are forwarded to the offending body, but no legal action is pursued. According to staff at the Attorney General's office, there is not sufficient funding for legal action in such cases.

The Attorney General's office has not kept statistics as to the frequency, nature, or resolution of complaints under these sections.

POSSIBLE ALTERNATIVES

The stated impediment to more aggressive exercise of the Section 8216 oversight authority is a lack of funding. This could be remedied in one of two ways: (1) appropriate new funds for enforcement, or (2) require more aggressive enforcement within existing resources.

Appropriation of new funds would probably be the approach preferred by the Attorney General, as it would not require that resources be reallocated from existing projects to fund enforcement of Section 8216. If the Commission decides to pursue this approach, the staff will work with the Attorney General's office to determine the proper amount to be appropriated. Considering that statistics on the number and nature of complaints have not been kept, it may be difficult to determine the proper amount.

Alternatively, the section could be amended to require more aggressive enforcement, without an appropriation. This could be done either by making legal action mandatory, or by requiring that legal action be made a "priority" relative to other responsibilities of the Attorney General. The amendment could expressly require that legal action be funded from existing resources. This would

require that resources be shifted away from other programs, overriding the Attorney General's own judgment about the best allocation of law enforcement resources. This is almost certain to be opposed by the Attorney General. It also seems likely that a perceived shift of funds away from crime-fighting, in order to help private individuals in disputes with private associations, would be politically unpopular.

Either one of these approaches could be implemented on a limited basis, as a pilot project. A pilot project could test the cost and feasibility of legal action before deciding whether a permanent change is warranted.

CONCLUSION

Existing law and practice provides some help to homeowners in disputes with their homeowners association. It probably does not help members of an unincorporated association, or members with disputes over the governance requirements of Davis-Stirling. Those limitations could be addressed by amending Section 8216 so that it applies to unincorporated associations (to the extent they are subject to the relevant provisions of the Corporations Code) and to the governance rules of the Davis-Stirling Act.

Because it is limited in scope to disputes over governance matters, Section 8216 may not be sufficient to resolve many substantive disputes. However, to authorize Attorney General oversight of substantive disputes would go far beyond existing law and the merits of such an approach are beyond the scope of this memorandum.

The reach of Attorney General oversight under Section 8216 is limited by a perceived lack of funds to support legal action. Unless the Commission wishes to recommend additional funding or limit the Attorney General's discretion as to enforcement of Section 8216, the oversight will remain limited to nonlegal action (forwarding letters of complaint). This is more than token assistance, as an official inquiry may well resolve many governance disputes, but it is far less than is possible under the rather formidable set of legal actions authorized in the section.

Finally, the Commission is considering creation of an information clearinghouse, which could produce informational materials and respond to inquiries about the law governing common interest developments. Considering that the Attorney General already has some involvement in overseeing

homeowners associations, it may make sense to assign the clearinghouse function to the Attorney General as well. The clearinghouse idea will be considered more fully in another memorandum.

Respectfully submitted,

Brian Hebert
Staff Counsel

Exhibit

Corp. Code § 8216. Enforcement

(a) The Attorney General, upon complaint of a member, director or officer, that a corporation is failing to comply with the provisions of this chapter, Chapter 5 (commencing with Section 7510), Chapter 6 (commencing with Section 7610) or Chapter 13 (commencing with Section 8310), may, in the name of the people of the State of California, send to the principal office of such corporation, (or, if there is no such office, to the office or residence of the chief executive officer or secretary, of the corporation, as set forth in the most recent statement filed pursuant to Section 8210) notice of the complaint. If the answer is not satisfactory, or if there is no answer within 30 days, the Attorney General may institute, maintain or intervene in such suits, actions, or proceedings of any type in any court or tribunal of competent jurisdiction or before any administrative agency for such relief by way of injunction, the dissolution of entities, the appointment of receivers or any other temporary, preliminary, provisional or final remedies as may be appropriate to protect the rights of members or to undo the consequences of failure to comply with such requirements. In any such action, suit or proceeding there may be joined as parties all persons and entities responsible for or affected by such activity.

(b) In the case of a corporation where the action concerns assets held in charitable trust, the Attorney General may bring an action under subdivision (a) without having received a complaint, and without first giving notice of a complaint.

BILL LOCKYER
Attorney General

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November 16, 1999

Frederick L. Pilot
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RE: Homeowners Associations

Dear Mr. Pilot:

Thank you for writing to the office of Attorney General Bill Lockyer regarding the limited authority granted to the Attorney General by the Legislature to enforce certain rights of members of non-profit mutual benefit corporations. Please excuse this belated response to your letter of September 10, 1999.

Initially, you should know that the Attorney General's authority under Corporations Code § 8216 is discretionary rather than mandatory. This means that the Attorney General may choose to intervene in members disputes with non-profit mutual benefit corporations or not intervene at all. The statute also allows the Attorney General to determine the extent of his involvement and further limits his authority to the enforcement of certain narrowly proscribed members rights such as access to corporate books, voting rights, notice of annual meetings and access to lists of members, to name a few.

Common interest development homeowner associations are established by law as non-profit mutual benefit corporations when the developer turns them over to the homeowners. These homeowner associations are regulated in law both by the non-profit mutual benefit sections of the California Corporations Code and also by the Davis-Stirling Common Interest Development Act (California Civil Code §§ 1350 et seq.). While the Attorney General has some limited discretionary authority under the Corporations Code, California law does not grant the Attorney General the authority to enforce the provisions of the Davis-Stirling Act.

It is the long standing policy of the Attorney General's office to exercise our discretionary authority established in Corporations Code § 8216 by providing a public service to members of non-profit mutual benefit corporations who complain to us in writing that their rights, as

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enumerated in that body of law, have been violated. Our involvement takes the form of sending a "notice of complaint" letter to the board of directors of the corporation. In many instances, our "notice" letter is effective in resolving the complaint or at least encouraging a board to review its procedures in relationship to the law. However, complainants whose disputes are not resolved as a result of our informal intervention are directed to seek private civil remedies if they wish to continue to pursue the matter. Government cannot be expected to resolve all civil disputes at taxpayers expense as the costs of litigation and the required bureaucracy are prohibitive. Further, the regulations provided in the Davis-Stirling Act are much broader and provide better protection for an aggrieved homeowner.

Your letter of September 10, 1999 requests statistics on the number of complaints regarding suspected violations of the Corporations Code by homeowners associations that were received by the Attorney General's office for each year from 1994 through 1998. You also ask for the number of complaints that were resolved as a result of our "notice of complaint" letter. Unfortunately, we must decline to respond to your request as we have not kept the statistics you are seeking and the information is not available.

We appreciate your interest in this matter and sincerely regret that we are unable to be of help to you in this instance. We hope that the information that we have provided clarifies our restrictions in regard to your request.

Sincerely,


ROBERT M. RAYMER
Associate Governmental Program Analyst

For BILL LOCKYER
Attorney General