Study H-851 June 25, 2001

First Supplement to Memorandum 2001-54

Nonjudicial Dispute Resolution Under CID Law:
Administrative Hearing Procedure

In Memorandum 2001-54 the staff reviews the constraints on creating a state administrative hearing process for resolving CID disputes. A key consideration is the need to tie such a dispute resolution process to a program of state regulation.

Comments of James P. Lingl

We have now received email correspondence from James P. Lingl of Camarillo, who specializes in community association law. Mr. Lingl suggests that such a program could be lodged with the Department of Corporations. He notes that the vast majority of association disputes involve meetings, elections, voting, discipline and allegations of board or member misconduct, or problems involving association management companies. "Each of these activities, in turn, are aspects of corporate function. They are already largely regulated — not by the Davis-Stirling Act — but by the Nonprofit Mutual Benefit Law."

Although Department of Corporations oversight of corporate activities is limited, the jurisdiction of that agency could be extended. Mr. Lingl suggests:

> Instead of trying to re-invent the wheel, and trying to find a way to create a governmental agency which would try to enforce the REAL PROPERTY law aspects of association disputes, why could we not just go back to the Department of Corporations, give it some additional adjudicative authority to enforce existing corporate law and provide a venue for lodging complaints about California nonprofit mutual benefit corporations whose Boards of Directors or shareholder/members are violating corporate statutes or Department Rules. Would that not significantly avoid the whole line of McHugh cases?

Mr. Lingl notes that there are other CID disputes that do not lend themselves to corporate law resolution. These involve ownership interests, easements — property rights in general — that can probably only be dealt with in traditional courts of law. "But by and large, the vast majority of garden variety disputes in associations are corporate in nature. These types would easily satisfy the two

pronged McHugh test if the agency was limited to dealing with corporate law dispute enforcement."

He suggests such a regulatory scheme could involve creation of departmental regulations along the lines of those issued by the Department of Real Estate. The corporate oversight and dispute resolution function could be funded by a $1 per unit charge, plus a sliding scale fee based on the size of the development, paid along with the association's other fees on an annual basis. He refers us to past legislative efforts to develop such a regulatory scheme.

In his correspondence, Mr. Lingl also notes two other changes he thinks would be beneficial:

(1) The ultimate remedy for a homeowner unhappy with a board's actions is to seek removal of board members. However, the way the law is written, if an association has cumulative voting (which is mandated for new associations by Department of Real Estate), no individual director can be removed unless the entire board is removed. Corp. Code § 7222. "The Commission should probably look at whether the removal of director provision should be changed."

(2) Some types of disputes will necessarily have to be resolved in court. But Mr. Lingl suggests that there is a role for Code of Civil Procedure Section 1238 (submitting a controversy without action). Under that provision the parties may submit an agreed-upon statement of facts to the court for resolution of the controversy. "Could we make it mandatory after ADR fails?"

Mr. Lingl concludes:

> If you focus on the corporate side of activities and create some meaningful oversight, but [leave] the real property part to be worked out by the owners themselves or settled in court, then the model can be fixed. If we try to do both, we will be hopelessly tied up by special interest groups, by constitutional impediments, and by the realities of personal living choices that are not subject to any degree of legislative fiat.

Staff Comments

We have made inquiry of the Department of Corporations as to possible expansion of their jurisdiction, as suggested by Mr. Lingl. The staff would summarize their response as unenthusiastic. Their area of expertise is securities regulation. Moreover, they are ill-equipped to take on a task of the magnitude being suggested here.

Other potential candidates to conduct an administrative adjudication dispute resolution system include Department of Real Estate and Department of Justice. Each of those two entities already has a role in CID oversight, so expansion of their jurisdiction in the area would not be completely foreign.

As we have indicated previously, Office of Administrative Hearings conducts adjudicative hearings for Department of Real Estate. However, under an administrative adjudication scheme, the Department (or Commissioner) would retain ultimate power of decision. There is a potential conflict here between DRE's role in CID development and its possible role in CID operations.

Under existing law the Attorney General has oversight authority in some aspects of CID operations under the Nonprofit Mutual Benefit Corporation Law. The types of issues the Attorney General is involved with are the very types of corporate governance issues Mr. Lingl suggests would be amenable to administrative adjudication treatment. We have made inquiry of the Department of Justice to ascertain their reaction to the possibility of being given an administrative adjudication function for CID operations. We will report back at the meeting, if we have further input by then.

Respectfully submitted,

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Executive Secretary