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Memorandum 2001-55

Nonjudicial Dispute Resolution Under CID Law: Due Process in Association Rulemaking and Decisionmaking

The association governing a common interest development ("homeowners association") has many decisionmaking powers analogous to those of a local government entity. It can "legislate" (by amendment of the documents that govern its operations and the rights and obligations of its members), and "adjudicate" (by exercise of its power to enforce restrictions). This memorandum describes the procedures that govern exercise of these powers and considers their adequacy in light of Constitutional due process requirements and other sources of law that require procedural fairness.

Decisionmaking procedures themselves do not provide a mechanism for resolving disputes between a homeowners association and its members. However, if the procedures provide meaningful notice and an opportunity to be heard, many disputes may be *avoided* at the outset, either because the association takes the homeowner's views into account in making a decision, or because the homeowner feels that, whatever the decision, he or she has been treated fairly.

Procedures alone do not ensure fairness. In addition, the association must follow the required procedures and it must do so in good faith. There are a number of things that could improve the likelihood of good faith compliance with decisionmaking procedures: education of directors and members as to what the law requires, sanctions for noncompliance, revision of Davis-Stirling so that its requirements are more clearly stated, etc. These approaches are worthy of study, but are beyond the scope of this memorandum. They will be considered more fully later in this study.

The contents of the memorandum are organized as follows:

LAW GOVERNING ASSOCIATION DECISIONMAKING

A homeowners association is subject to Department of Real Estate ("Department") regulations, the Davis-Stirling Common Interest Development Act, the Nonprofit Mutual Benefit Corporation Law (if it is incorporated — as most are), the common law, and the Constitution.

The requirements of the Department's regulations are somewhat indirect. As part of the necessary review and approval of a proposed CID, the Department reviews the governing documents to determine whether they include "reasonable arrangements" for management of the CID. Bus. & Prof. Code § 11018.5(e). Department regulations specify arrangements that it deems reasonable for different aspects of management. If a CID's governing documents satisfy these standards, its arrangements will be found reasonable. Thus, most CID governing documents will initially include provisions consistent with the "reasonable arrangements" spelled out in Department regulations. Once the developer controls less than 25 percent of the votes, the governing documents can be amended without prior approval of the Department. See Bus. & Prof. Code § 11018.7. The Department's "reasonable arrangements" can then be modified or removed if the association chooses.

Procedural requirements governing enforcement decisions, levying of assessments, and amendment of governing documents are described below.

Architectural Review

The declarations of most homeowners associations contain a restriction imposing architectural and aesthetic limits on the owners. The declaration may set out general or detailed standards and may grant enforcement authority to the board or to a separate review committee. Typically, an owner wishing to make a change to his or her property will submit a proposal to the reviewing body and that body will then decide whether the proposal is consistent with the aesthetic standards set out in the declaration.

The statutory or regulatory law governing architectural review is scant. The Department's regulations include a few provisions relating to the composition of an "architectural control committee" — providing that it shall have three to five members, and giving the developer majority control of appointments for five years after approval of the subdivision, or until 90 percent or more of the units have been sold, whichever comes first. 10 Cal. Code Regs. § 2792.28. There do not seem to be any other regulatory or statutory procedural requirements governing architectural and aesthetic decisionmaking. There is case law regarding procedural requirements in architectural decisionmaking, as discussed later in this memorandum.

Member Discipline

According to the Department's regulations, a homeowners association may discipline a member by imposition of "monetary penalties, temporary suspensions of an owner's rights as a member of the Association or other appropriate discipline" for a failure to comply with the association's governing instruments, provided that notice and hearing procedures satisfying the minimum requirements of Corporations Code Section 7341 are followed. 10 Cal. Code Regs. § 2792.26(b). Section 7341 provides the following minimum procedures for termination or suspension of the membership rights of a member of a mutual benefit corporation. The procedure, which must be carried out in good faith and in a fair and reasonable manner, is as follows:

(1) The association's disciplinary procedure must be set out in the articles or bylaws and provided to members at least annually.
(2) The member must be notified 15 days prior to disciplinary action.

(3) The member must have an opportunity to be heard, either orally or in writing, not less than five days before the effective date of the discipline.

Notice must be given in a form reasonably calculated to provide actual notice. Mail notice must be sent first class or registered to the last address of the member shown on the association's records.

These minimal procedures are supplemented by the following requirements of the Davis-Stirling Act:

(1) If a board adopts a policy imposing monetary penalties on members for violation of governing documents, it must adopt a schedule of monetary penalties for the different types of violation and distribute the schedule to each member, by personal delivery or first-class mail. The schedule must be "in accordance with authorization for member discipline contained in the governing documents." Civ. Code § 1363(g).

(2) Before a board meets to consider disciplining a member, it must notify the member in writing, by personal delivery or first-class mail, at least 10 days before meeting. The notice must specify the time and place of the meeting, identify the nature of the alleged violation, and must state that the member has a right to appear and be heard (in executive session, if the member wishes). If the board disciplines a member, it must provide notice of the disciplinary action, by personal delivery or first-class mail, within 15 days.

Presumably, the more protective notice and hearing provisions in Davis-Stirling would control.

Delinquent Assessments

Although it doesn't involve significant decisionmaking, the process of collecting a delinquent assessment is worth describing briefly. The procedure is as follows: if an assessment is delinquent (at least 15 days overdue), the association may recover the amount due, reasonable collection costs, a modest late charge, and interest. Civ. Code § 1366(e). The association may place a lien on the delinquent owner's separate property interest to collect those amounts. Before doing so, the association must do the following:

(1) Notify the owner by certified mail of the fee and penalty procedures of the association. Civ. Code § 1367(a).

(2) Provide an itemized statement of the charges owed by the owner, including items on the statement that indicate the principal owed, any late charges and the method of calculation, any attorney's fees, and the collection practices used by the association, including the right of the association to the reasonable costs of collection. *Id.*

(3) Record, in any county in which the property is located, a notice of delinquent assessment, which states the amount of the assessment and other sums imposed in accordance with Section 1366, a legal description of the owner's interest in the common interest development against which the assessment and other sums are levied, the name of the record owner, and, if the lien is to be enforced by nonjudicial foreclosure, the name and address of the trustee authorized by the association to enforce the lien by sale. The notice of delinquent assessment must be signed by the person designated in the declaration or by the association for that purpose, or if no one is designated, by the president of the association, and mailed to all record owners of the owner's interest no later than 10 calendar days after recordation. Civ. Code § 1367(b).

If, after a lien is recorded, the debt is paid, the association must record a notice stating the satisfaction and release of the lien. *Id.* If the debt is not paid within 30 days after recording of the lien, the lien may be enforced in any manner permitted by the law, including sale by the court, or sale by the trustee pursuant to Civil Code Sections 2924, 2924b, and 2924c. Civ. Code § 1367(e). See generally C. Sproul & K. Rosenberry, Advising California Condominium & Homeowners Associations §§ 4.25-4.27, at 176-79 (Cal. Cont. Ed. Bar 1991) (procedure for trustee's sale).

ASSESSMENTS

A homeowners association is required to levy regular and special assessments sufficient to fulfill its obligations under the governing documents and Davis-Stirling. Civ. Code § 1366(a). However, there are limits on increase of the regular assessment and the levying of special assessments. These are described below.

At least 30 days (but no more than 60 days) before increasing a regular assessment or levying a special assessment, the association must provide notice by first-class mail to the owners. Civ. Code § 1366(d). Before increasing an annual assessment, the board must have distributed its annual operating budget, as required by Civil Code Section 1365(a), or it must obtain the approval of a

majority of a quorum of the members, at a meeting or in an election. Civ. Code § 1366(a).

Except in an emergency situation, approval of a majority of a quorum of the members, at a meeting or in an election, is required before an association may increase the regular assessment by more than 20 percent over the regular assessment for the preceding fiscal year, or levy special assessments aggregating five percent or more of the budgeted gross expenses of the association for "that" fiscal year. Civ. Code § 1366(b). As drafted, it isn't clear whether the reference to "that" fiscal year means the fiscal year in which the assessments are levied, or the preceding fiscal year. For reasons having to do with the history of the provision, it is likely that the provision is meant to refer to the fiscal year in which the assessment is levied, rather than the preceding fiscal year. See C. Sproul & K. Rosenberry, Advising California Condominium & Homeowners Associations § 4.2B, at 44-46 (Cal. Cont. Ed. Bar Supp. 2001). **The staff recommends** that Section 1366 be revised to eliminate the ambiguity.

An assessment may be increased or levied without member approval in emergency situations. Emergency situations exist where the following expenses arise:

> (1) An extraordinary expense required by an order of a court.
> (2) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the association is responsible where a threat to personal safety on the property is discovered.
> (3) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the association is responsible that could not have been reasonably foreseen by the board in preparing and distributing the pro forma operating budget under Section 1365. However, prior to the imposition or collection of an assessment based on this type of emergency situation, the board must pass a resolution containing written findings as to the necessity of the extraordinary expense involved and why the expense was not or could not have been reasonably foreseen in the budgeting process. The resolution must be distributed to the members with the notice of assessment.

Civ. Code § 1366(b).

AMENDMENT OF GOVERNING DOCUMENTS

The members and management of a CID are subject to the rules and restrictions stated in the CID's governing documents. These include the recorded declaration, the bylaws, the articles of incorporation, and any "rules and regulations" adopted by the homeowners association. The procedures for amendment of the different types of governing documents are described briefly below.

Declaration

The "declaration" contains a legal description of the CID, a statement of its legal character, and a list of any restrictions on use or enjoyment of the property that are intended to be enforceable equitable servitudes. Civ. Code § 1354. Unless a declaration provides that it is not amendable, it can be amended at any time. Civ. Code § 1355(b).

Procedural requirements for amendment of the governing documents will typically be provided in the governing documents themselves, consistent with the Department's regulations, which specify the percentage of vote required for approval of a change. 10 Cal. Code Regs. § 2792.24(a).

In addition to any procedures imposed by the governing documents, there are three different sets of statutory procedures for amendment of a declaration:

(1) A general procedure. See Civ. Code § 1355.
(2) A simplified procedure for deletion of developer provisions. Civ. Code § 1355.5.
(3) A judicial procedure, available where the electoral process has failed. Civ. Code § 1356.

Because this memorandum is concerned with the fairness of a homeowners association's own decisionmaking procedures, the judicial procedure is not described. The general and simplified procedures are described below.

General Amendment Procedure

Civil Code Section 1355 specifies the general procedure for amending a declaration. Section 1355 is somewhat confusing and should be revised to improve its clarity. It appears to require advance notice to members of a proposed amendment, approval by a majority of members, certification of the

vote by an association officer, and recording of the amendment in counties where the CID is located.

Deletion of Developer Provisions

Civil Code Section 1355.5 provides an optional procedure for deletion of a declaration provisions that are related to construction and marketing of the development, once construction and marketing is complete. Notice of the proposed change must be mailed to all owners, by first class mail, at least 30 days before the proposed action. The notice must include the proposed amendments and state the time and place of the board meeting at which the action will be considered. Approval of a majority of at least 50 percent of those owners who own no more than two separate interests is required.

Articles of Incorporation

If a homeowners association is incorporated, it must file articles of incorporation. The articles identify and describe the corporation, and can include provisions regarding member rights and management of the corporation. Corp. Code § 7130-7132.

The Department's regulation regarding amendment of articles requires approval by a specified majority of the governing body, of the voting power of the association, and of members other than the subdivider. 10 Cal. Code Regs. § 2702.24(b)(1).

The Corporations Code provides its own rules regarding amendment of the articles. With certain narrow exceptions (Corp. Code §§ 7811, 7812), amendment of the articles requires approval of the board, a majority of a quorum of members present at a board meeting (Corp. Code § 5034), and any other person whose approval is required by the articles themselves. Corp. Code § 7812. See also Corp. Code § 7813 (approval of member class). Given that Section 7812 expressly incorporates any provision of the articles requiring approval of a particular person, the stricter requirements of the governing documents probably control.

An amendment is effective when certification of the amendment is filed with the Secretary of State. Corp. Code §§ 7814, 7816-7817.

Bylaws

An association's bylaws will typically include provisions describing its structure and management and the rights of its members. See, e.g., Corp. Code § 7151 (provisions of bylaws of mutual benefit corporation).

The Department's regulation provides that amendment of bylaws requires approval by a specified majority of the voting power of the association and of members other than the subdivider. 10 Cal. Code Regs. § 2792.24(b).

With respect to an incorporated association, Corporations Code Section 7150 provides that bylaws may be amended by the board, acting alone, unless the amendment would do any of the following:

(1) Materially and adversely affect the rights of members as to voting, dissolution , redemption, or transfer.
(2) Increase or decrease the number of members authorized in total or for any class.
(3) Effect an exchange, reclassification or cancellation of all or part of the memberships.
(4) Authorize a new class of membership.

However, the Section also provides that a corporation's articles or bylaws may restrict or eliminate the power of the board to amend bylaws. Corp. Code § 7150(c). Thus, stricter approval requirements in the governing documents should control. Section 7150(b) also provides for amendment of bylaws by members, on approval of a majority of a quorum (and of a class if the action would affect the class' interests). Presumably, the stricter requirement in the governing documents would control here as well, though this is not entirely clear.

The rule, in Corporations Code Section 7150, providing for board approval in specified circumstances, may also make sense for an unincorporated association (which would not be subject to this provision of the Corporations Code). When the Commission turns its attention to the proper relationship between Davis-Stirling and the Corporations Code, it should consider making Section 7150 applicable to all homeowners association, regardless of whether they are incorporated.

Operational Rules

The definition of "governing documents" includes the "operating rules of the association" as distinct from its declaration, articles, and bylaws. Civ. Code § 1351(j). The Department's regulations provide that the governing body of a CID may formulate "rules of operation of the common areas and facilities owned or controlled by the Association." 10 Cal. Code Regs. § 2792.21(a)(7). See also C. Sproul & K. Rosenberry, Advising California Condominium & Homeowners Associations § 1.24, at 23 (Cal. Cont. Ed. Bar 1991) ("In addition to the basic

governing documents, an association may adopt its own internal rules and regulations to implement the provisions of the declaration and other governing documents. The internal rules are not recorded and are not enforceable as equitable servitudes, and are therefore supplemental to the provisions of the declaration and the other governing documents.").

The Department's regulations vest authority to adopt rules and regulations in the "governing body" rather than in the members. Presumably, rulemaking by a homeowners association takes place at board meetings, which are subject to the general procedural requirements applicable to board meetings. For example, the Department's regulations require that meetings be held regularly, with advance notice posted prominently within the subdivision. 10 Cal. Code Regs. § 2792.20. The Davis-Stirling Act also regulates the time and manner of meeting notice, and provides that members must be permitted to speak at any meeting except when the board adjourns to executive session. Civ. Code § 1363.05. A board may meet in executive session only to consider "litigation, matters relating to the formation of contracts with third parties, member discipline, or personnel matters." *Id.*

WHAT PROCESS IS DUE?

One question considered by this memorandum is whether the regulatory and statutory procedures for homeowners association decisionmaking, discussed above, satisfy Constitutional due process requirements. This question can be broken down into two parts: (1) What process does the Constitution require? (2) Does the Constitutional requirement apply to a private homeowners association? This section of the memo considers the first part. It does so by briefly describing the due process requirements that apply to local government entity decisionmaking. This is helpful because the types of decisions made by a homeowners association are similar to those made by local governments.

The Constitution provides that a person shall not be deprived of property without due process of law. The essence of procedural due process is advance notice and an opportunity to be heard. *Fuentes v. Shevin*, 407 U.S. 67, 80 (1972) ("For more than a century the central meaning of procedural due process has been clear: 'Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified.' It is equally fundamental that the right to notice and an opportunity to be heard 'must be granted at a meaningful time and in a meaningful manner.'").

Case law interpretation makes clear that due process is only required with respect to government actions that are adjudicative in nature. "Legislative action is not burdened by such requirements." *Horn v. County of Ventura*, 24 Cal. 3d 605, 612-13 (1979). A decision affecting an individual is adjudicative if it is determined by facts peculiar to the individual case (e.g., granting a variance from a zoning rule). *Id.* at 613. A decision is legislative if it involves adoption of a "broad, generally applicable rule of conduct on the basis of general public policy" (e.g., adopting an ordinance) *Id.* The adjudicative-legislative distinction is justified as follows:

> Where a rule of conduct applies to more than a few people it is impracticable that everyone should have a direct voice in its adoption. The Constitution does not require all public acts to be done in town meeting or an assembly of the whole. General statutes within the state power are passed that affect the person or property of individuals, sometimes to the point of ruin, without giving them a chance to be heard. Their rights are protected in the only way that they can be in a complex society, by their power, immediate or remote, over those who make the rule.

Id. (quoting *Bi-Metallic Co. v. Colorado*, 239 U.S. 441 (1915)).

Procedural requirements governing adjudicative and legislative decisionmaking by a local government entity are briefly discussed and compared with analogous homeowners association procedures, below.

Adjudicative Decisions

Before making an adjudicative decision depriving a person of a significant interest in property, a local government entity must provide due process of law. The specific procedural requirements vary depending on the nature of the decision and the interests affected. However, the general requirements have been described as follows:

> The procedure employed must be fair and accord those with an interest in the matter a meaningful opportunity to prepare and be heard. Formal rules of evidence are not required. Public hearings are not required unless specified by state law or local ordinance. The decision maker must be fair and impartial.

League of California Cities, California Municipal Law Handbook II-38 (2000). Of the procedures for adjudicative decisionmaking by a homeowners association described above, the member discipline procedure should satisfy this general

due process standard — the association's disciplinary procedure (including any schedule of monetary penalties) must be set out in the governing documents, advance notice is provided to the member facing discipline, who is also accorded an opportunity to be heard. Fair procedures for architectural review are not spelled out in regulation or statute. This deficiency is discussed more fully below.

Legislative Decisions

Although a local government entity is not constitutionally required to provide due process before making a legislative decision, it is worth noting that there are statutory notice and comment procedures that apply. The Ralph M. Brown Act requires that the legislative body of a local public agency hold regular meetings. Gov't Code § 54954(a). Advance notice of those meetings, including an agenda, must be posted and mailed to persons who have requested notice and the meetings must be open and public. Gov't Code §§ 54954.1, 54954.2(a). Members of the public must be permitted to address the legislative body on items considered by the body. Gov't Code § 54954.3. Thus, a local government entity must provide public notice and an opportunity to be heard before making a legislative decision (which would necessarily be made at a meeting).

Note that the procedures for legislative decisionmaking by a homeowners association (amendment of governing documents and levying of assessments) are generally more protective than similar procedures of a local government agency. With the exception of amendment of operational rules, all of the procedures require direct approval by some percentage of the members. Legislative decisionmaking by local government entities does not involve this kind of direct democratic participation. Amendment of a homeowners association's operating rules appears to be as fair as local government legislative decisionmaking — in each case open meeting laws allow for general public notice and comment before action is taken.

APPLICABILITY OF CONSTITUTIONAL REQUIREMENTS

Due process is a constitutional requirement. The Constitution governs the relationship between the government and its citizens. It does so by restricting state action in various circumstances. A homeowners association is not a state entity. Thus, at first glance it would appear that constitutional requirements do not apply to decisionmaking by a homeowners association. However, there are circumstances where constitutional requirements have been applied to the

actions of private entities. The likelihood of constitutional requirements being applied to a homeowners association is discussed by Professor Katharine Rosenberry in her article *The Application of the Federal and State Constitutions to Condominiums, Cooperatives, and Planned Developments*, 19 Real Prop., Prob. & Tr. J. 1 (1984)). Professor Rosenberry identifies three bases on which the constitution might be applied to a homeowners association:

(1) Where state action is required to enforce a homeowners association rule. In *Shelley v. Kraemer*, 334 U.S. 1 (1948), the Supreme Court held that state action exists where a court enforces a racially restrictive covenant. Because both the buyer and the seller in that case wished to ignore the covenant, it would not have been enforced but for the intervention of the court. The scope of the *Shelley* doctrine is presently unclear:

> Some courts essentially limit the application of *Shelley* to the judicial enforcement of racially restrictive covenants. Other courts interpret *Shelley* as proscribing the judicial enforcement of covenants that discriminate on grounds other than race as well as covenants that abridge fundamental rights guaranteed by the Due Process Clause and the first eight amendments to the Constitution. Other courts, whether accepting of a narrow or a broad interpretation of the rights protected by *Shelley*, limit the application of the *Shelley* holding to circumstances in which judicial enforcement of a private covenant is contrary to the wishes of parties to a transaction to which the covenant applies, a circumstance that was present in *Shelley*. Still other courts, explicitly or implicitly recognizing the functional similarity of the restrictive covenant in *Shelley* to government land-use regulation, have applied the *Shelley* holding broadly when the matter at issue has been the enforcement of restrictive covenants that controlled the use and occupation of land.

Siegel, *The Constitution and Private Government: Toward The Recognition Of Constitutional Rights in Private Residential Communities Fifty Years After Marsh v. Alabama*, 6 Wm. & Mary Bill Rts. J. 461, 493-94 (1998).

(2) Where there is a sufficiently close nexus or symbiotic relationship between private conduct and state action.

> Under the sufficiently close nexus theory, state action is found when there is a sufficiently close nexus between the particular state involvement and the challenged private conduct to enable a court to conclude that the private conduct can be attributed to the state. State action is found under the "symbiotic relationship" theory

> when the state has so insinuated itself into a position of interdependence with a private party that the state can be considered a joint participant in the challenged behavior.

Rosenberry at 11. In *Park Redlands Covenant Control Committee v. Simon*, 181 Cal. App. 3d 87 (1986), the court held that a CID restriction limiting the number of occupants permitted in a dwelling violated the right of privacy guaranteed in the California Constitution. The court found state action based on the city's involvement in requiring the developer to include the restriction in the CID's governing documents. "State action is present where an executive officer aids or encourages the violation of rights. " *Id*. at 99.

(3) Where a homeowners association is the "functional equivalent of a municipality." In *Marsh v. Alabama*, a Jehovah's Witness was prevented from distributing literature in Chickasaw, Alabama, an entirely private "company town." 326 U.S. 501 (1946). Because Chickasaw was the functional equivalent of a municipality, providing residences, shops, roads, sewers, police protection, etc., the court held that First Amendment rights extended to its streets, even though privately-owned. In a later case, the Supreme Court made clear that the *Marsh* doctrine is very narrow:

> The question is, under what circumstances can private property be treated as though it were public? The answer that *Marsh* gives is when that property has taken on *all* the attributes of a town, i.e., "residential buildings, streets, a system of sewers, a sewage disposal plant and a 'business block' on which business places are situated."

Hudgens v. NLRB, 424 U.S. 507, 516 (1976) (emphasis in original). Based on *Hudgens* and subsequent cases, Professor Rosenberry concludes (at 23):

> [In] order to apply the *Marsh* doctrine, the common-interest development would have to provide the full range of public services. It would have to provide fire and police protection, medical services, schools, and mail service. The property would also have to have a business district which provides a range of commercial facilities. Most common-interest developments do not provide this full range of services, and, thus, are not the functional equivalent of a municipality. Some, however, may be.

Conclusion. Is a private homeowners association subject to Constitutional due process requirements? Perhaps, in some cases. If a homeowners association fails to provide due process in its own internal decisionmaking process and then

seeks to enforce its decision in court, the involvement of the state in enforcing the results of an unfair process might involve sufficient state action to justify application of constitutional principles. Alternatively, if due process is denied as a result of some active involvement of a state entity (as in the *Park Redlands* case, where the city required adoption of an unconstitutional covenant as a condition of granting a conditional use permit) the due process violation could be attributed to the state. Finally, if a homeowners association assumes all of the trappings of a municipality, a court could conclude that it is the functional equivalent of a municipality and impose constitutional principles on that basis.

FIDUCIARY BASIS FOR DUE PROCESS IN DECISIONMAKING

In *Cohen v. Kite Hill Community Ass'n*, 142 Cal. App. 3d 642, 651 (1983) (citations omitted), the court discussed the powers and responsibilities of a homeowners association:

> "[U]pon analysis of the association's functions, one clearly sees the association as a quasi-government entity paralleling in almost every case the powers, duties, and responsibilities of a municipal government. As a 'mini-government,' the association provides to its members, in almost every case, utility services, road maintenance, street and common area lighting, and refuse removal. In many cases, it also provides security services and various forms of communication within the community. There is, moreover, a clear analogy to the municipal police and public safety functions. All of these functions are financed through assessments or taxes levied upon the members of the community, with powers vested in the board of directors, council of co-owners, board of managers, or other similar body clearly analogous to the governing body of a municipality."
>
> … And the powers of such associations are extensive.…
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> With power, of course, comes the potential for abuse. Therefore, the Association must be held to a high standard of responsibility: "The business and governmental aspects of the association and the association's relationship to its members clearly give rise to a special sense of responsibility upon the officers and directors.... This special responsibility is manifested in the requirements of fiduciary duties and the requirements of due process, equal protection, and fair dealing."

The *Cohen* opinion uses constitutional language to describe the duty owed by a homeowners association to its members ("due process, equal protection") but does not expressly describe the fairness requirement as constitutional in origin.

Nor does it discuss what state action would justify the application of constitutional requirements to a private homeowners association. Considering its characterization of a homeowners association as "quasi-governmental" the court may have considered the association to be the functional equivalent of a municipality. If so, that would represent a significant broadening of the *Marsh* doctrine. It seems more likely that the court simply used constitutional terminology to illustrate the level of procedural fairness required as part of the homeowners association's heightened duty to its members. Regardless of whether a homeowners association is subject to constitutional due process requirements or an analogous fiduciary duty, courts have held that a homeowners association must use fair procedures in adjudicative decisionmaking.

In *Cohen*, the homeowners association approved construction of a wall that did not conform to detailed architectural restrictions and consequently obstructed a neighbors view. The neighbors' efforts to persuade the association to reverse its decision failed and they sued. The court analogized the decision allowing the nonconforming fence design to an administrative award of a zoning variance and held that it would apply the same standard of review that governs review of a zoning variance award (citing *Topanga Ass'n for a Scenic Community v. County of Los Angeles*, 11 Cal. 3d 506 (1974), as the authority on such review). The court in *Topanga* required that the variance board "render findings sufficient both to enable the parties to determine whether and on what basis they should seek review and, in the event of review, to apprise a reviewing court of the basis for the board's action. *Id.* at 514.

In *Ironwood Owners Ass'n IX v. Solomon*, 178 Cal. App. 3d 766 (1986), a homeowners association sought an injunction ordering removal of eight palm trees planted by a member without prior approval of the association's Architectural Control Committee. The trial court granted summary judgment in favor of the association. The appeals court reversed, holding that the association had not followed adequate procedures in concluding that the trees violated the CCRs. As the court noted:

> When a homeowners' association seeks to enforce the provisions of its CCRs to compel an act by one of its member owners, it is incumbent upon it to show that it has followed its own standards and procedures prior to pursuing such a remedy, that those procedures were fair and reasonable, and that its substantive

> decision was made in good faith, and is reasonable, not arbitrary or capricious."

ADEQUACY OF DECISIONMAKING PROCEDURES

Do the procedures for decisionmaking by a homeowners association meet the standards of procedural fairness discussed above? With respect to "adjudicative" decisionmaking, the procedures for member discipline seem reasonably fair. So long as carried out in good faith, they should satisfy the requirements of due process, whether Constitutional or fiduciary in origin. However, the absence of any procedure for architectural review is problematic. The case law clearly requires that due process be provided in making architectural decisions, but a homeowners association is not given any regulatory or statutory guidance as to what procedure should be followed. This problem is discussed more fully below.

With respect to "legislative" decisions, the procedures are generally more democratic than analogous procedures of a local government entity (which are not themselves subject to constitutional due process requirements). However, for reasons other than due process, it might be helpful to elaborate a procedure for adoption, amendment, and repeal of operational rules. That option is discussed below.

PROPOSED REFORMS

In addition to the minor revisions recommended in the body of this memorandum, the Commission should consider the following proposals:

Architectural Review

As discussed above, the courts have held that "due process" is required in a homeowners association's architectural decisionmaking process. However, there is no regulatory or statutory procedure to guide homeowners associations. The Commission should consider creating a simple, fair procedure to be followed in making architectural review decisions. The need for legislative direction has been noted:

> Although the decisions in *Cohen v. Kite Hill Community Ass'n* and I*ronwood Owners Ass'n IX v. Solomon* provide a basis for the courts to build a body of law setting forth due process requirements for architectural committees, it would be preferable if the legislature were to provide guidance. Thoughtful legislation designed to set forth procedural standards for architectural

> committees would be less costly and more effective than having these standards evolve on a trial-and-error basis through litigation.

Merritt & Siino, *Architectural Control Committees and the Search for Due Process*, 15 CEB Real Prop. L. Reporter 117, 123-24 (Apr. 1992).

The elements of a fair procedure for architectural decisionmaking are laid out in the following passage from *Advising California Condominium and Homeowners Associations*:

> (a) Require owners to submit requests for permission to make alterations, additions, or improvements in writing, preferably on a standard form. The procedures for requests to the architectural review committee should be spelled out very specifically, especially if the governing documents also contain the not uncommon provision that the committee's failure to act on a request within a specified number of days is deemed approval.…
>
> (b) Require that the architectural committee hold a hearing on any application and notify the applicant and any other affected owners of the hearing date at least ten days in advance of the hearing. An association is probably required to provide notice to affected owners when an owner seeks permission to make improvements just as a local governmental entity is required to notify neighboring owners when it considers an application for a zoning variance.…
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> (c) Require the architectural committee act on an application within a specified number of days, depending on the magnitude of the request.…
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> (d) Require that the architectural committee follow the procedures strictly and that the committee make findings of fact to support its decision.…
>
> (e) Set forth in the governing documents the guidelines … by which the architectural committee will make its decision.…

C. Sproul & K. Rosenberry, Advising California Condominium & Homeowners Associations § 8.6, at 362-63 (Cal. Cont. Ed. Bar 1991).

If the Commission agrees that it would be helpful to include a procedure for architectural decisionmaking, the staff will prepare a draft, consistent with the elements described above, for the Commission's review at a later meeting.

Operational Rulemaking

The Commission knows from its work on the rulemaking provisions of the Administrative Procedure Act that it is important for persons subject to a rule to have advance notice of the rule and an opportunity to comment on it before it

takes effect. It is also important that the rule be available to persons who are subject to it. This is not a matter of due process, but of good government. These principles seem to apply with equal force to the governance of a homeowners association. If the Commission agrees, the staff will draft a procedure for enacting, amending, and repealing the operational rules of a homeowners association. The procedure (which would be presented for the Commission's review at a later meeting), would include the following basic elements.

(1) Notice. Members should be given advance notice of a proposed rulemaking action.

(2) Comment. Members should have an opportunity to comment regarding a proposed rulemaking action before a final decision is made.

(3) Publication. All rules should be in writing and easily accessible to members.

Coordination Between Legal Requirements

On some subjects there are different procedural rules provided by the Department's regulations, Davis-Stirling, and the Corporations Code. It isn't always clear which rule controls. It might be helpful to review these areas of overlap and recommend language making clear which requirements are controlling. This sort of technical cleanup should not be given the same priority as other work on nonjudicial dispute resolution, but should be noted for later attention.

Respectfully submitted,

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