Study H-851 January 4, 2002

Memorandum 2002-10

**Nonjudicial Dispute Resolution under CID Law:
Alternative Dispute Resolution (Discussion of Issues)**

This memorandum explores issues relating to alternative dispute resolution in common interest developments. Attached to the memorandum are the following materials:

BACKGROUND

The Commission is reviewing, as a priority matter in the common interest development study, various options for nonjudicial dispute resolution. This effort responds to information the Commission has received demonstrating various destructive types of homeowner versus association disputes, with their attendant rancor and costs. It was the Commission's observation that many of these disputes started out as relatively small matters and escalated to full-scale warfare. Many of them perhaps could have been resolved early on with relatively small expense through adequate nonjudicial dispute resolution processes.

The Commission considered and rejected a number of alternatives, including development of a governmental entity to superintend the dispute resolution process, assignment of administrative adjudication responsibility to an existing governmental entity, and expansion of small claims court jurisdiction. This leaves us with two core areas of inquiry — (1) improvement of decision-making mechanisms within associations, and (2) further development of standard alternative dispute resolution techniques (principally mediation and arbitration). The Commission is proceeding on both fronts.

This memorandum deals with alternative dispute resolution issues. It begins with a discussion of some of the overarching policies involved. It then

recapitulates existing law relating to alternative dispute resolution in the common interest development context. It next explores four key issues — (1) what improvements in existing law appear to be appropriate, (2) what should be the mechanisms for conducting alternative dispute resolution, (3) how should alternative dispute resolution be funded, (4) what sorts of notification or informational mechanisms are appropriate.

The Commission has previously decided that it would not investigate expansion of small claims court jurisdiction to deal with CC&R enforcement issues. However, the Commission did decide to look into the possibility localizing assessment disputes in the small claims court. This memorandum opens that discussion.

Finally, the memorandum initiates consideration of a matter the Commission has expressed some interest in — the possibility of personal liability of a board member who does not engage in the decision-making process in good faith.

GENERAL POLICY CONSIDERATIONS

To put this discussion in perspective, it must be remembered that we are engaged in a calculated gamble here. If alternative dispute resolution techniques are successful, the parties will have been spared the substantial cost and delay of litigation. If they are unsuccessful, the parties will simply have been exposed to added cost and delay, before going to court for an effective resolution of their dispute.

This perspective is somewhat simplistic, however, because for many homeowners, the court system is simply not an option. They cannot afford the substantial expense of litigation. Alternative dispute resolution may be their only realistic opportunity for a satisfactory resolution of the dispute.

A related concern is the inherent inequality of the relative economic situations of the disputants. The association board has at its disposal the assets of the association, and is in a position to assess association members in order to finance any necessary litigation. The financial impact will be proportionately greater on an individual homeowner in a dispute with the association who is forced to bear expenses of litigation. There may be mechanisms to address this situation such as shifting of attorney's fees, but certainly the extent to which inexpensive dispute resolution options can be made available as an alternative must be a consideration.

We have been told that mediation often fails because in a CID dispute the board is not really interested in resolving the case, and participates only to the extent the law requires it. It has also been said that there is no incentive for an association board to engage in alternative dispute resolution because it knows it will be in a superior position, both economic and legal, if it simply stonewalls and forces litigation.

While this attitude may prevail in some cases, the staff does not have a sense that it is widespread. In fact, the few real statistics we have suggest that alternative dispute resolution can be effective.

SOME STATISTICS

To some extent, policy decisions concerning the use of alternative dispute resolution in the CID context will be influenced by the magnitude of the problem. Obviously, if the problem is a small one, we should not be looking at burdensome requirements that simply add expense and delay to the association decisionmaking process. If the problem is larger, that could suggest more aggressive remedies are appropriate.

Unfortunately, we do not have good statistics either on the amount of conflict in common interest communities or on the success of alternative dispute resolution processes in resolving conflicts. This is largely because the use of alternative dispute resolution in the CID context is relatively recent and not widespread. The best statistics come from the few jurisdictions where there is a governmental entity that oversees the dispute resolution process. Elsewhere, it's merely anecdotal.

Incidence of Problems in CIDs

In Montgomery County Maryland, the Office of Common Ownership Communities reports approximately 500 inquiries a year for about 100,000 housing units. That averages to one complaint per 200 housing units per year.

Initially, the newly-created Nevada Ombudsman handled around 1,000 inquiries a month for an estimated 135,000 housing units. That high complaint rate (one per 11 housing units per year) has declined substantially since a homeowner education program began in October. We do not have any recent statistics.

In New South Wales, Australia, the Department of Strata Schemes and Mediation Services reports 1300 complaints annually for 300,000 housing units. That yields one complaint per 230 housing units per year.

We have been seeking, but so far have been unable to obtain, statistics from the Division of Florida Land Sales, Condominiums and Mobile Homes.

The available statistics are spotty, and do not suggest a reliable basis for projecting to California. Assuming for the sake of argument, however, that a complaint rate of one per 200 units per year is about right, that would suggest a total of 175,000 complaints annually for California's estimated 3,500,000 CID housing units.

Resolution of Problems by ADR

The Montgomery County, Maryland, Office of Common Ownership Communities indicates that during the year 2000 it received 534 telephone inquiries, resulting in the filing of 36 disputes. Of these disputes, 13 went to formal mediation and seven to administrative adjudication. Three decisions or orders were issued, and judicial review was requested for only one of these.

New South Wales states that it refers 830 of its disputes to mediation annually. They have experienced a 58.5% success rate. Despite the modest success rate, a survey of participants indicates that 85% of them feel the process was fair and 81% say they'd use it again. Only 4% of the participants ultimately proceeded to adjudication, after the failure of their mediation.

The American Arbitration Association has reported a success rate of 75-90% in the mediations it conducts. However, it is not clear where the actual percentage for homeowner association disputes falls within this range.

We suspect that the success rate for mediation may be higher where a governmental entity is superintending the process than where the parties are left to their own devices. That is in part because a trained evaluator can, and does, refer to mediation those disputes that appear to be ripe for resolution, while weeding out those that will need to be resolved by litigation or other means.

Anecdotes from California

In California, we only have anecdotal information about the success or failure of alternative dispute resolution in the CID context.

One attorney who specializes in CID law has indicated a fair amount of success with mediation. Susan M. Hawks McClintic has told the Commission

that, “In my experience, this has been very effective in addressing disputes between associations and members. In San Diego, we often use the San Diego Mediation Center which provides mediation services at a very nominal cost.” This information appears to be contradicted, however, by information apparently originating *from the same law firm* that not one owner has benefited in any way from the California statute requiring an offer of alternative dispute resolution before judicial proceedings are instituted. Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227, 239 (2001).

We have received only positive information from Northern California. An East Bay mediator who specializes in CID matters, Janet Quinn Dennis, tells us that she has had a 100% success rate in her mediations. Sandy Bonato, a CID attorney, indicates a success rate of about 80% in disputes her firm is familiar with that have gone to mediation.

However, these favorable experiences are not universal. We have received comments from a number of homeowners indicating mediation has not worked well in their cases. They attribute it to the basic intransigence of the board of directors in their cases.

THE POLICY DEBATE

The Commission has received a fair amount of correspondence concerning the policy of strengthening alternative dispute resolution requirements. It is not possible to characterize the proponents and opponents as being either board representatives or homeowner partisans, since they come from all parts of the spectrum.

In Favor of ADR

We have received commentary from a number of persons involved on both the homeowners side and the management side indicating there is value in the alternative dispute resolution process. The mere involvement of a neutral party, if nothing more, can aid in bringing civility and moderation to the situation.

We have heard form Timothy Lange, a senior citizens advocate, that there needs to be more education, training, conflict resolution, mediation, and arbitration, with the courts as a last alternative. He cautions, though, to “Please bear in mind, there is a real and significant cost for taking your board to task,

informally, formally, and including mediation. These are not strangers, but our neighbors who serve."

Likewise, it has been argued that, "Because the vast majority of CID Disputes involve people in a continuing relationship, mediation generally is the dispute-resolution of choice." See Williams, King, Shapiro, & Rosenbaum, *Resolving Common Interest Development Disputes*, SF Daily Journal p. 5 (Dec. 22, 1999). They note that the types of conflicts that typically arise in the CID context — architectural controls (including improvements, painting, and landscaping), pet problems, and people to people interactions (including facilities use, noise, and rudeness) — lend themselves to mediation as a nonjudgmental forum in which to resolve these disputes.

A number of homeowners have written to us that litigation is simply not a viable option for many homeowners; effective nonjudicial dispute resolution mechanisms are needed. E.g., "Litigation is not a poor man's option. We have had a lawyer write a letter to the board of directors, but even he estimates that to go to court to protect our rights would cost at least $25,000-$30,000. Even if we prevailed, there is no guarantee that we would recoup our costs. We don't have this kind of money."

In Opposition to ADR

On the other hand, we have seen a fair amount of criticism, also from both the homeowner perspective and the management perspective. A key concern of both antagonists is that requiring ADR as a prerequisite to judicial resolution just adds costs and expense.

A number of homeowners have relayed their experience that the requirement to engage in ADR is nonproductive — it simply adds hurdles in the way of judicial resolution of the issue. A recent communication we have received from Florida, for example, details a dispute over access to records that went to arbitration. Homeowners advocates, dissatisfied with the outcome of the arbitration, express cynicism over the value of arbitration, accusing the arbitrator of complicity. "If this is the way DBPR arbitrators work, condo owners are definitely much better off by going to court directly." P. Flamingo, *Don't Fall into the DBPR Arbitration Trap!* (12/6/01).

Donie Vanitzian has written to us on several occasions detailing the problems with mandating ADR. She notes that both mediation and arbitration are costly and time consuming. Neither tolls the statute of limitations and neither requires a

decision based on law. “Mediation is ineffective for homeowners in a CID, and arbitration can not only be confusing for the homeowner complainant, it is more often than not, futile.” Ms. Vanitzian’s concerns are further elaborated in the letter attached as Exhibit pp. 4-7. In addition to concerns about tolling the statute of limitations, the cost to the homeowner of ADR, the lack of a decision based on law, and the confusing nature of ADR, she lists the following issues:

(1) A claimant is often required to agree to binding ADR and give up any right to appeal as a condition of engaging in ADR

(2) There are no caps on costs or mediator or arbitrator fees

(3) There is no due process in ADR proceedings

(4) There is no mandatory disclosure of educational requirements for mediators and arbitrators

(5) Homeowners are pressured to choose ADR to resolve their dispute, putting them in an inferior position to exercise their rights in a court of law

(6) Homeowners can and do end up paying the respondent’s costs

Robert Lewin has written to us that ADR will not solve the fundamental problem, which is whether homeowner associations wield disproportionate power and whether their enforcement of CC&Rs is subject to sufficient independent scrutiny. He notes that ADR is becoming overly litigious in character, and cites Ms. Vanitzian’s concerns with it. He has also provided us with material suggesting that an arbitrator is not required to follow the rule of law, that there is bias among ADR decisionmakers, and that the costs are substantial.

The criticism is not confined to homeowners, however. We have received at least one letter form an attorney representing associations, who would not like to see additional ADR requirements imposed. See letter of Debora M. Zumwalt, Exhibit pp. 8-13. Ms. Zumwalt points out that the law currently provides plenty of protections for the homeowner involved in foreclosure procedures for nonpayment of assessments. “There simply is no need to impose additional mediation requirements. Additional requirements would serve to allow the owner to delay the process, and cause the Association to incur more attorney’s fees, which will ultimately be passed on to the owner.” She indicates that, at least with regard to assessment disputes, the existing statutory mediation procedure is adequate for any issues that arise. See Civ. Code § 1366.3.

A recently-published law review article goes further and contends that even the existing California statute encouraging use of ADR does more harm than

good. See Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227 (2001). Prof. Batchelder states that, "ADR may be well suited to some disputes in CIDs. However, disputes over indisputable obligations like assessments are not suited to ADR." Id. at 239. His criticism appears to be directed primarily at the Civil Code Section 1366.3 assessment dispute procedure, rather than the Civil Code Section 1354 non-assessment dispute procedure. He thinks the ADR option just gets in the way of prompt collection by the association and adds unnecessary cost to the procedure.

SUMMARY OF EXISTING LAW

The Davis-Stirling Act includes a number of provisions relating to alternative dispute resolution. The key statutes are Civil Code Sections 1354 and 1366.3, the text of which is attached as Exhibit pp. 1-3.

The main ADR provision — Section 1354 — was added in 1994 in an effort to divert the growing number of minor disputes involving CC&Rs out of congested courts. It was intended to encourage ADR for disputes involving relatively minor issues, such as the height of fences, color of paint, number of vehicles, outbuildings, and similar disputes that characterize contemporary life in residential neighborhoods.

The Davis-Stirling Act also provides for a form of ADR in developer-association disputes (construction design and defect). Civ. Code § 1375. However, that is not the focus of the present inquiry, which relates to association-homeowner disputes.

Mandatory ADR (Civ. Code § 1354(b))

Before either the association or an owner or member may file an action to enforce an association's governing documents (CC&Rs, bylaws, operating rules, etc.), the parties "shall endeavor" to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration, which may be binding or nonbinding at the option of the parties. This process is initiated by a party serving a "Request for Resolution" on the other party. The request is deemed rejected if not accepted within 30 days (thereby enabling the requesting party to proceed to court). If the request is accepted, ADR must be completed within 90 days. If not completed within 90 days, apparently the parties may proceed to court. The parties bear the costs of ADR.

This provision is limited in its application. It comes into play only if the action is solely for declaratory or injunctive relief (or for that type of relief in conjunction with a claim for damages not exceeding $5,000). It does not apply to a claim for association assessments, even if less than $5,000. Moreover, the court may excuse a party's failure to seek ADR in any of the following circumstances (Civ. Code § 1354(c)):

(a) Preliminary or injunctive relief is "necessary".

(b) The limitation period for bringing the action would run within 120 days after the filing of the action.

(c) The court finds that dismissal for failure to request ADR would result in substantial prejudice to a party.

Mandatory ADR for Assessment Disputes (Civ. Code § 1366.3)

Although the mandatory ADR provisions of Section 1354(b) do not by their terms apply to assessment disputes, they may be invoked by a homeowner who pays under protest the amount of the assessment plus late charges, interest, delinquency costs. This procedure may not be used by the homeowner more than twice a year nor more than thrice in five years.

Mandatory ADR in Governing Documents

The Davis-Stirling Act does not address the issue of alternative dispute resolution (e.g., mandatory arbitration), that may be required in an association's governing documents. At least one provision of the Davis-Stirling Act suggests that such a requirement might be enforceable. See Section 1366.3(a) (association must inform owner who pays assessment under protest of "any other procedures to resolve the dispute that may be available through the association".)

There is at least one recent case holding a mandatory arbitration clause in CC&Rs unenforceable because unconscionable. *Villa Milano Homeowners Ass'n v. Il Davorge*, 84 Cal. App. 4th 819, 102 Cal. Rptr. 2d 1 (2000). However, this was a clause limiting the association's right to sue the developer for design and construction defects. Different policy considerations would be implicated by a mandatory arbitration clause relating to association-homeowner disputes.

Department of Real Estate regulations relating to the contents of an association's governing documents indicate that the governing body should ordinarily be authorized to institute, defend, settle or intervene on behalf of the association in litigation, arbitration, mediation, or administrative proceedings in

matters pertaining to enforcement of the governing instruments. 10 Cal. Code Regs. § 2792.8(26).

Voluntary ADR (Civ. Code § 1354(d))

If either the association or an owner has filed an action to enforce the association's governing documents, the action may be stayed and the matter referred to ADR on written stipulation of the parties. Trial court delay reduction rules do not apply during the time the action is stayed. The parties bear the costs of ADR.

Attorney's Fees (Civ. Code § 1354(f))

An incentive for the parties to agree to ADR is found in Section 1354(f), which assesses attorney's fees against the losing party in the event of a lawsuit. The statute also gives the court discretion, in determining the amount awarded, to "consider a party's refusal to participate in alternative dispute resolution prior to the filing of an action."

Confidentiality of ADR Communications (Civ. Cod § 1354(g)-(h))

An added incentive for ADR is the confidentiality granted to ADR communications by Section 1354(g)-(h).

Informing Homeowners (Civ. Code § 1354(i)-(j))

The Davis-Stirling Act includes mechanisms for informing affected persons of its ADR provisions. Members of the association "shall annually be provided a summary of Section 1354." When a Request for Resolution is served on a disputant, it must be accompanied by the text of Section 1354.

EVALUATION AND IMPROVEMENT OF EXISTING LAW

Critics have noted that although existing law provides for alternative dispute resolution, when a member actually requests ADR, the law allows the board to refuse (and many boards do). There is no motivation for a board to prefer ADR over litigation since the board's action is afforded presumptive validity in the court system. This forces the homeowner to file a lawsuit, which in most cases is beyond the homeowner's capability, particularly for the types of issues that may be involved in these disputes. We have received one comment to the effect that boards of directors in most cases refuse ADR as they know the homeowner does not have the financial wherewithal to hire an attorney.

Critics have also indicated that small claims court may be the homeowner's only practical remedy, but it is precisely the small claims cases that are subjected by the Davis-Stirling Act to the ADR requirement, providing a recalcitrant board the opportunity to delay litigation.

The "loser pays" provision for litigation under the Davis-Stirling Act should be an incentive for the parties to make use of ADR. But it has been suggested that, as a practical matter, this does not deter the board from litigation. Litigation is funded by the association (including assessments contributed by the dissident homeowner), so there is no strong motivation for the board to reach a nonjudicial resolution. Moreover, directors are immunized from personal liability for improper decisionmaking by both the law and mandatory insurance coverage paid by the association. In fact, it has been alleged that professional managers and their lawyers encourage litigation because of the fees it generates.

In addition to these general concerns, a number of criticisms have been leveled at details of the Davis-Stirling ADR statute. See Sproul, *Alternative Dispute Resolution for Common Interest Developments: Recent Amendments to Civil Code Section 1354 Fall Short*, 12 Cal. Real Prop. J. 28 (1994); Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227 (2001).

We have seen mixed reviews about the effectiveness of the nonjudicial dispute resolution mechanisms currently available to CIDs under California law. While the policy debate does not necessarily signal that a dramatic expansion or contraction of existing California law is warranted, there are some obvious ways in which the existing scheme can be improved, to the benefit of all concerned.

Communication Between Board and Homeowner

At the most fundamental level, when a disagreement arises it should ordinarily be addressed at the outset by further communication between the board and the homeowner. Once the positions and reasoning of the parities are explained to each other, the dispute may be readily resolved. That is the obvious way to proceed, but that does not necessarily occur in every case.

Possible reasons for failure of communication include the homeowner's perception that the board has made up its mind and further discussion is futile, and the board's perception that the homeowner is a troublemaker and can't be dealt with rationally. Both of which may be true, but not necessarily.

Would it help to require that communications between the board and homeowner are confidential? This has previously been suggested to the Commission by Donie Vanitzian.

The law already provides for confidentiality in the context of ADR communications. The concept behind further extending confidentiality protection to communications in a dispute would be to encourage open and frank exchanges between the parties without fear of reprisal or exposure to abuse by association members.

Whatever the theoretical benefits of confidentiality might be, the staff has a number of concerns with this proposal. How do we tell when ordinary communication between homeowners and the board has shifted from routine to dispute-related? If all communications were made confidential, that would destroy the concept of openness in the conduct of association business, as well as the ability of homeowners to mount an electoral challenge to incumbent board members (which is the ultimate remedy for board malfeasance).

One possibility would be to trigger confidentiality on request of the homeowner involved in the dialogue. Perhaps something along the following lines could be workable:

> If an owner and the board of directors of an association are involved in a dispute, on written request of the owner all communications between them concerning the dispute shall be kept confidential.

There would undoubtedly be some logistical problems with such a provision. Also, what would be the consequences of violation of it? Violation by the board would arguably be treatable in the same manner as other breaches of its fiduciary obligation. And suppose negotiations break down and the dispute moves to court; will the homeowner's hands be tied in any effort to show bad faith by the board?

On balance, the staff recommends **against** such a provision.

Procedures Provided in Governing Documents

The governing documents of an association may, and probably should, provide for a dispute resolution process suited to the association's needs. This could be something as simple as a process by which a homeowner who disagrees with a board decision can have an opportunity to be heard. We have been told

that in many cases all most homeowners really want is assurance that they their position has been fairly heard and considered by the board.

The Montgomery County, Maryland, dispute resolution scheme requires that the parties have made a good faith attempt to exhaust all procedures provided in the association documents (and that at least 60 days have elapsed since those procedures were initiated), before a dispute may be filed with the Commission on Common Interest Communities. This requirement has apparently been quite salutary in getting the disputants to resolve their dispute without the need for any outside intervention.

New Jersey mandates that planned real estate developments provide "a fair and efficient procedure" for the resolution of disputes between individual unit owners and the association, and between unit owners. The procedure must be "readily available" as an alternative to litigation. The scope of the New Jersey requirement is not clear. We have no information about what sorts of procedures may or may not satisfy the New Jersey mandate.

Existing California law relating to alternative dispute resolution for assessment disputes refers to various dispute resolution options, including "any other procedures to resolve the dispute that may be available through the association." Civ. Code § 1366.3(a). In addition, California law requires that the disputants "shall endeavor" to submit their dispute to "a form" of alternative dispute resolution before filing a lawsuit. Civ. Code § 1354(b).

The staff believes an internal dispute resolution procedure of this sort could be quite productive, and **it would be worth the Commission's while** to explore the possibility of mandating it. An association could adopt a procedure suited to its circumstances. We could provide a simple default procedure for an association that fails to adopt its own — e.g., an opportunity for the aggrieved homeowner to present the homeowner's case in writing to a single member of the board who has been delegated authority to settle the dispute (consistent with the law and governing documents), and a brief appeal to the full board (including the right to appear in person). For an analogous procedure, see discussion below of "Association Decisionmaking Process".

If the Commission is interested in exploring such an option, we will prepare a draft for a subsequent meeting.

Mandatory ADR in Governing Documents

California law does not address the extent to which the governing documents of an association may mandate a dispute resolution process such as binding arbitration.

A number of other jurisdictions deal with the matter directly. Illinois law, for example, makes clear that a condominium association may require mediation or arbitration of disputes that arise out of violations of the governing documents or that involve $10,000 or less (other than assessments). Any arbitration is governed by the Illinois Uniform Arbitration Act. The association may require the disputants to bear the costs of mediation or arbitration.

Kentucky provides that the governing documents may include a procedure for submitting to arbitration or other impartial determination disputes arising from the administration of a condominium association. Massachusetts permits the bylaws to provide for arbitration to resolve disputes arising from the administration of a condominium.

One concern is that such a clause mandating ADR may not be apparent to a homeowner buying an interest in a CID, who may inadvertently be giving up the right to a day in court. Of course, the governing documents of a CID can be quite extensive, and there may be many significant ramifications of CID living the homeowner is unaware of at the time of purchase. It can be argued that the prospective buyer has plenty of opportunity to read the governing documents in advance of purchase. Whether, realistically, this will be done, and if done, whether the homeowner will have a practical appreciation for the consequences of various provisions, is questionable. In any event, the homeowner may not have a practical choice if the only affordable housing option available is a CID with a mandatory dispute resolution clause.

On the other hand, ADR is perhaps better suited than the court system for resolution of the types of disputes that arise in the CID context. Mediation, particularly, may be helpful in light of the fact that the parties must continue in an ongoing relationship with each other. And in the case of arbitration, its lower cost may be the only practical way for some homeowners to get a determination by a neutral decisionmaker in the case.

In any event the staff thinks **California law should make clear**, one way or the other, whether it is permissible for an association to mandate ADR in its governing documents. This is a policy issue the Commission needs to determine.

ADR Prerequisite to Litigation

The Davis-Stirling Act (Code Civ. Proc. § 1354(b)) requires as a prerequisite to litigation that the plaintiff first offer to resolve the dispute by ADR. With editorial subdivisions inserted to improve legibility somewhat, the statute provides that:

> (A) Unless the applicable time limitation for commencing the action would run within 120 days, prior to the filing of a civil action by either an association or an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages, other than association assessments, not in excess of five thousand dollars ($5,000), related to the enforcement of the governing documents, the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration. The form of alternative dispute resolution chosen may be binding or nonbinding at the option of the parties.
>
> (B) Any party to such a dispute may initiate this process by serving on another party to the dispute a Request for Resolution. The Request for Resolution shall include (1) a brief description of the dispute between the parties, (2) a request for alternative dispute resolution, and (3) a notice that the party receiving the Request for Resolution is required to respond thereto within 30 days of receipt or it will be deemed rejected.
>
> (C) Service of the Request for Resolution shall be in the same manner as prescribed for service in a small claims action as provided in Section 116.340 of the Code of Civil Procedure.
>
> (D) Parties receiving a Request for Resolution shall have 30 days following service of the Request for Resolution to accept or reject alternative dispute resolution and, if not accepted within the 30-day period by a party, shall be deemed rejected by that party.
>
> (E) If alternative dispute resolution is accepted by the party upon whom the Request for Resolution is served, the alternative dispute resolution shall be completed within 90 days of receipt of the acceptance by the party initiating the Request for Resolution, unless extended by written stipulation signed by both parties. The costs of the alternative dispute resolution shall be borne by the parties.

This process is enforced by the requirement that the plaintiff include with the complaint a certificate of compliance. Failure to file the certificate makes the complaint demurrable. Civ. Code § 1354(c).

The statute is susceptible to improvement in a number of respects:

Statute of Limitations

The statute excuses compliance with the ADR requirement if the statute of limitations would run within 120 days after service of the Request for Resolution. That is presumably because the statute provides for a 30-day response period plus a 90-day ADR period.

Would it unduly complicate the statute to provide that the Request for Resolution simply tolls the relevant statute of limitations? One problem is that it may be difficult to tell when an open-ended ADR process has been concluded for purposes of determining the end of the tolling period.

A **better alternative** may be to provide that a statute of limitations that would otherwise expire within the ADR period is tolled until 120 days after service of the Request for Resolution:

> ~~Unless the applicable time limitation for commencing the action would run within 120 days, prior to~~ Before the filing of a civil action by either an association or an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages, other than association assessments, not in excess of five thousand dollars ($5,000), related to the enforcement of the governing documents, the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration.
>
> If the applicable time limitation for commencing the action would run within 120 days after service of the Request for Resolution, the time limitation is extended to the 120th day after service.

Such a provision might give a litigant extra time to satisfy the statute of limitations. But the time extension is limited, and the revision would address the problem of the litigant who waits until the day before the statute runs before filing a lawsuit (thereby avoiding the need to attempt ADR).

If this change is adopted, a conforming revision would be required in Section 1354(c):

> The failure to file a certificate as required by subdivision (b) shall be grounds for a demurrer pursuant to Section 430.10 of the Code of Civil Procedure or a motion to strike pursuant to Section 435 of the Code of Civil Procedure unless the filing party certifies in writing that one of the other parties to the dispute refused alternative dispute resolution prior to the filing of the complaint~~,~~ or

that preliminary or temporary injunctive relief is necessary, ~~or that alternative dispute resolution is not required by subdivision (b), because the limitation period for bringing the action would have run within the 120-day period next following the filing of the action~~, or the court finds that dismissal of the action for failure to comply with subdivision (b) would result in substantial prejudice to one of the parties.

Scope of Requirement

The Section 1354 ADR demand applies in actions "related to the enforcement of the governing documents" of an association. It may not be clear, however, whether the action is to enforce governing documents or to enforce some other legal requirement.

Curtis Sproul points out, for example, that the Corporations Code establishes various procedures for contesting elections or getting access to books and records that are often repeated in an association's bylaws. Is an action to enforce those procedures an action related to the governing documents, or simply to enforce a statutory right?

This suggests to the staff that **the scope of the ADR requirement is unduly narrow**. ADR should be attempted in homeowner versus association disputes generally, other than assessment disputes (which are covered by a separate statute). We would rephrase the statute so that it is not unduly limited:

> Before the filing of a civil action ~~by either~~ between an association ~~or~~ and an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages, other than association assessments, not in excess of five thousand dollars ($5,000), ~~related to the enforcement of the governing documents~~, the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration.

A conforming revision would be required to Section 1354(c):

> At the time of filing a civil action ~~by either~~ between an association ~~or~~ and an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages not in excess of five thousand dollars ($5,000), ~~related to the enforcement of the governing documents~~, the party filing the action shall file with the complaint a certificate stating

> that alternative dispute resolution has been completed in compliance with subdivision (b).

Is the limitation to lawsuits for declaratory or injunctive relief also unduly restrictive? The staff does not think so. They types of disputes that typically arise within an association and about which we are concerned ordinarily involve ongoing behavior or prohibitions that are unique to life in a common interest community. Lawsuits for compensatory damages for injury to person or property caused by an association or by another resident are not unique to common interest communities and ought not to be treated differently from similar lawsuits outside the CID context. Lawsuits involving imposition or collection of assessments are treated separately.

Disputes Involving Small Amounts

Prof. Batchelder argues that ADR can be more expensive than adjudication in many small disputes. He gives the example of a homeowner who thinks the association should replace the homeowner's backyard fence, but the association thinks that under the governing documents it's the homeowner's responsibility. "Rather than simply replace it and sue in small claims court, he may have to offer ADR first, thus incurring the additional expense of the ADR process in addition to the cost of the fence." Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227, 238 (2001).

Of course, the existing statute only requires ADR for lawsuits within the monetary jurisdiction of the small claims court when they are coupled with a claim for declaratory or injunctive relief. Under existing law, the homeowner could do exactly what Prof. Batchelder suggests should be the rule — skip ADR and go directly to small claims court for reimbursement.

The staff doesn't see any harm in further clarifying this matter, thus perhaps eliminating possible confusion over it:

> Before the filing of a civil action between an association and an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages, other than association assessments, not in excess of five thousand dollars ($5,000), the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration. Nothing in this section requires the parties to submit a dispute to alternative dispute

resolution if the dispute does not involve a claim for declaratory relief or injunctive relief.

Type of ADR

The statute is notably vague as to the type of ADR that must be engaged in. The statute simply states that the parties must endeavor to submit their dispute to "a form" of alternative dispute resolution "such as" mediation or arbitration. The form of alternative dispute resolution chosen may be binding or nonbinding "at the option of the parties."

If the board offers the homeowner the chance to engage in standard internal association procedures, is that sufficient? Should conciliation be mentioned as one of the ADR options? Suppose one party makes an offer of mediation, and the other party responds with a counteroffer of binding arbitration?

The staff does not think we need to get overly legalistic here. The object is to try to get the parties talking to each other. If a homeowner has not taken advantage of internal dispute resolution procedures, it should be sufficient for the association to offer that as a prerequisite for filing suit, provided the internal procedures are fair and reasonable. That suggests, at a minimum, that a neutral ought to be involved.

The staff would simply **make clear that ADR, within the meaning of the statute, can encompass a range** of nonjudicial dispute resolution processes:

> the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration, conciliation, or other nonjudicial procedures that involve a neutral party in the decisionmaking process, including association procedures that are fair and reasonable. The form of alternative dispute resolution chosen may be binding or nonbinding at the option of the parties.

Manner of Service

One of the more common complaints we have heard about the existing statute is that the manner provided for service of an ADR request is unworkable. Code of Civil Procedure Section 116.340 provides for mailing by the court clerk, personal delivery by the plaintiff, or substituted service by the sheriff. Practitioners tell us the clerk will not mail, and sending the sheriff seldom wins friends (although it gets peoples' attention). Personal service works, but can't really be done by a board member, as by that time there is already significant tension. The cost and effect of a process server raise their own issues.

Practitioners have suggested that service by first class mail should be authorized, consistent with good sense and actual practice. (Certified mail is also an option, although it is frequently refused or not picked up.) Jim Lingl says, "The point is to *communicate* the request, not so much to prove that you have tried. First class mail actually does both. Besides, the local low cost ADR centers almost all use the phone and first class mail to arrange mediation sessions anyway, so the statute is being generally ignored as it is."

The staff would **revise the service provision** of the existing statute to read:

> Service of the Request for Resolution shall be in the same manner as prescribed for service in a small claims action as provided in Section 116.340 of the Code of Civil Procedure or by first class or certified mail.

Time for Completing ADR

Curtis Sproul suggests that the 30- and 90-day ADR triggers in the statute are not sufficiently long:

> These time constraints are likely to discourage the use of ADR methods requiring that the parties cooperate in selecting a hearing panel, as precious time can be consumed in merely selecting the arbitrators or mediators. When time following the ADR session is allocated to the hearing officer or panel to deliberate and reach a decision (if arbitration is selected), very little time may be left for scheduling the hearing and conducting any discovery. If mediation is the prescribed form of ADR, the mediation activities and subsequent discussion concerning recommended dispute resolution alternatives will consume additional time and resources.

The statute does allow the parties to extend the 90-day period for completing ADR by written stipulation. The staff thinks **this is sufficient**, if the parties are seriously interested in resolving the dispute without litigation. The only issue we see is the statute of limitations problem. This can be addressed by further tolling the statute during the written stipulation period:

> If the applicable time limitation for commencing the action would run within 120 days after service of the Request for Resolution, the time limitation is extended to the 120th day after service. If the parties stipulate to an extension of the alternative dispute resolution period beyond the 120th day after service, a time limitation that would run during the alternative dispute resolution period is extended to the end of the stipulated period.

Rejection of Request for ADR

While Section 1354 requires a plaintiff to offer ADR, it does not require the defendant to accept the offer. In other words California does not really have mandatory ADR for CID disputes.

Some other jurisdictions do. Florida, for example, has required nonbinding arbitration or mediation for CID disputes at least since 1992. Judicial review is available, but is discouraged by an award of litigation expenses against a party who fails to obtain a more favorable judgment. Nevada has a similar scheme. Hawaii does not mandate ADR, but does require it on request of a party to a CID dispute.

Would it make sense for California to move to mandatory ADR for CID disputes? Mandatory mediation is almost a contradiction in terms; traditional theory is that mediation must be voluntary in order to succeed. Florida handles this by providing that parties to an arbitration can convert the arbitration to a mediation by agreement.

Deborah Hensler, a professor of dispute resolution on the Stanford Law School faculty, has indicated to the staff that use of voluntary procedures to resolve disputes in this area is obviously beneficial. But she is skeptical about mandating nonjudicial procedures. Arbitration is confusing to many persons, including lawyers, who do not necessarily understand the procedures and details involved and the rights being given up in the process. And mediation, by its nature, cannot work unless it is voluntary.

There are at least two pilot programs in California involving mandatory mediation in civil cases. See Code Civ. Proc. §§ 1730 *et seq*. (court-related alternative dispute resolution processes) and 1775 *et seq*. (civil action mediation). In both programs, the Judicial Council is required to report back to the Legislature concerning experience under them. The staff has spoken with Judicial Council personnel involved with these programs. They indicate their report will not be available until the end of 2002. However, they do note that they understand that in Los Angeles County people are pretty pleased with the results of the pilot projects.

Further information about experience with mandatory mediation will be helpful. Also, although experience with mandatory judicial arbitration (Code Civ. Proc. § 1141.10 *et seq*.) has been reasonably positive, criticisms of the judicial arbitration system have surfaced in recent years, and a dialogue about its functionality is developing. With this in mind, the staff suggests that the

Commission **hold off on any decision** whether to propose mandatory ADR for CID disputes.

There are ways, however, in which alternative dispute resolution is encouraged, even though not mandated. Under existing law, the principle technique is the award of attorney's fees, discussed below. There may be other techniques available, such as shifting presumptions or burdens of proof in litigation against a party that refuses to participate in ADR. Other options would be to make ADR more attractive to the parties by one means or another, such as expanding the scope of judicial review of arbitration or subsidizing the cost of ADR. These options are also discussed below.

ADR for Assessment Disputes on Demand (Civ. Code § 1366.3)

Dispute resolution schemes in California and elsewhere typically exclude assessment challenges from their operation. The apparent reason for this is that assessments are ordinarily applied uniformly throughout the CID, and are based on the board's judgment of the amount necessary to adequately operate and maintain the CID. This is a determination vested by the association in the board. What would be the consequence for this scheme, and for the rest of the community, if an individual owner could obtain a lower assessment by engaging the board in mediation or arbitration?

Although the mandatory ADR provisions of Section 1354(b) do not apply automatically to assessment disputes, they be made applicable by a homeowner who pays an assessment under protest:

> 1366.3. (a) The exception for disputes related to association assessments in subdivision (b) of Section 1354 shall not apply if, in a dispute between the owner of a separate interest and the association regarding the assessments imposed by the association, the owner of the separate interest chooses to pay in full to the association all of the charges listed in paragraphs (1) to (4), inclusive, and states by written notice that the amount is paid under protest, and the written notice is mailed by certified mail not more than 30 days from the recording of a notice of delinquent assessment in accordance with Section 1367; and in those instances, the association shall inform the owner that the owner may resolve the dispute through alternative dispute resolution as set forth in Section 1354, civil action, and any other procedures to resolve the dispute that may be available through the association.
>
> (1) The amount of the assessment in dispute.
>
> (2) Late charges.

(3) Interest.

(4) All fees and costs associated with the preparation and filing of a notice of delinquent assessment, including all mailing costs, and including attorney's fees not to exceed four hundred twenty-five dollars ($425).

(b) The right of any owner of a separate interest to utilize alternative dispute resolution under this section may not be exercised more than two times in any single calendar year, and not more than three times within any five calendar years. Nothing within this section shall preclude any owner of a separate interest and the association, upon mutual agreement, from entering into alternative dispute resolution for a number of times in excess of the limits set forth in this section. The owner of a separate interest may request and be awarded through alternative dispute resolution reasonable interest to be paid by the association on the total amount paid under paragraphs (1) to (4), inclusive, of subdivision (a), if it is determined through alternative dispute resolution that the assessment levied by the association was not correctly levied.

It is not clear whether this section gives the homeowner the right to mandate ADR, for example to force nonbinding arbitration. The section seems to imply that the homeowner can require ADR, but then it incorporates by reference Section 1354(b), with makes ADR optional.

It is also not clear what a homeowner gains by invoking the Section 1366.3 procedure — it appears to simply delay the homeowner from going to court. It apparently would not enable the homeowner to recover attorney's fees if the homeowner prevails in court (see discussion below), since the attorney's fee provision applies only in an action to enforce covenants and restrictions. (Of course it is conceivable that an action to challenge the amount of an assessment could be considered an action to enforce covenants and restrictions. We have not seen any case law on this.) See discussion of attorney's fees below.

This provision is also criticized in Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227, 239 (2001). Prof. Batchelder argues that the only possible function of ADR in this circumstance is to educate the homeowner on the amount already owed and increase that amount by the additional costs generated by the ADR process. ADR is not useful in an assessment dispute because the board of directors has no discretion to compromise out a valid assessment, to the detriment of other association members.

Voluntary ADR (Civ. Code § 1354(d))

Section 1354(d) provides that in the case of litigation to enforce the association's governing documents, the action may be stayed and the matter referred to ADR on written stipulation of the parties:

> (d) Once a civil action specified in subdivision (a) to enforce the governing documents has been filed by either an association or an owner or member of a common interest development, upon written stipulation of the parties the matter may be referred to alternative dispute resolution and stayed. The costs of the alternative dispute resolution shall be borne by the parties. During this referral, the action shall not be subject to the rules implementing subdivision (c) of Section 68603 of the Government Code.

Subdivision (a) referred to in this provision states:

> (a) The covenants and restrictions in the declaration shall be enforceable equitable servitudes, unless unreasonable, and shall inure to the benefit of and bind all owners of separate interests in the development. Unless the declaration states otherwise, these servitudes may be enforced by any owner of a separate interest or by the association, or by both.

The ability to stipulate to ADR and obtain an exemption from fast track rules is helpful. But why should the provision be limited in its scope? The staff would **expand the coverage** of Section 1354(d):

> (d) Once a civil action ~~specified in subdivision (a) to enforce the governing documents~~ has been filed ~~by either~~ between an association ~~or~~ and an owner or member of a common interest development, upon written stipulation of the parties the matter may be referred to alternative dispute resolution and stayed. The costs of the alternative dispute resolution shall be borne by the parties. During this referral, the action shall not be subject to the rules implementing subdivision (c) of Section 68603 of the Government Code.

Attorney's Fees (Civ. Code § 1354(f))

The ADR "stick" is attorney's fees under Section 1354(f):

> (f) In any action specified in subdivision (a) to enforce the governing documents, the prevailing party shall be awarded reasonable attorney's fees and costs. Upon motion by any party for attorney's fees and costs to be awarded to the prevailing party in these actions, **the court, in determining the amount of the award,**

may consider a party's refusal to participate in alternative dispute resolution prior to the filing of the action.

This provision allows the court to consider a party's refusal to participate in ADR. But what constitutes a refusal to participate? If a homeowner demands binding arbitration and the board responds with an offer of mediation (which is rejected by the homeowner), who is the refusing party? The staff does not think the statute needs to spell this out; the courts should be able to handle it in a rational way.

A more significant issue, in the staff's opinion, is whether this provision should be limited to actions "specified in subdivision (a) to enforce the governing documents". An action under subdivision (a) is narrowly limited to enforcement of "covenants and restrictions in the declaration" as equitable servitudes. Curtis Sproul argues convincingly that the attorney's fee statute was probably erroneously drafted — it is intended to refer to an action under subdivision (b), not (a). After all, it is (b) that relates to an action to enforce the governing documents. See Sproul, *Alternative Dispute Resolution for Common Interest Developments: Recent Amendments to Civil Code Section 1354 Fall Short*, 12 Cal. Real Prop. J. 28. 31-32 (1994).

The staff suggests the Commission consider **amending the attorney's fee statute** along the following lines:

> (f) In any action specified in subdivision ~~(a) to enforce the governing documents~~ (b), the prevailing party shall be awarded reasonable attorney's fees and costs. Upon motion by any party for attorney's fees and costs to be awarded to the prevailing party in these actions, the court, in determining the amount of the award, may consider a party's refusal to participate in alternative dispute resolution prior to the filing of the action.

This change would resolve the question whether disputes involving enforcement of an association's bylaws are covered by the attorney's fee provision. This question comes up in practice from time to time, and apparently there is pending litigation on the matter.

It is not clear whether the change would affect Section 1366.3, related to alternative dispute resolution in assessment disputes. See discussion above. It can be argued that actions "specified in subdivision (b)" do not include assessment disputes. But Section 1366.3 makes clear by its terms that an

assessment dispute is not excluded from subdivision (b) if the contested assessment is paid under protest. A **Comment could clarify** the matter.

Confidentiality of ADR Communications (Civ. Cod § 1354(g)-(h))

Section 1354(g)-(h) provides for confidentiality of alternative dispute resolution communications:

> (g) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), evidence of anything said or of admissions made in the course of the alternative dispute resolution process shall not be admissible in evidence, and testimony or disclosure of such a statement or admission may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.
>
> (h) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), documents prepared for the purpose or in the course of, or pursuant to, the alternative dispute resolution shall not be admissible in evidence, and disclosure of these documents may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.

These provisions were enacted before the Law Revision Commission's general mediation confidentiality statute (Evid. Code §§ 1115-1129). It is not clear whether the provisions are superseded by the general statute to the extent they apply to a mediation. These provisions would apparently still be good law to the extent they apply to an arbitration.

The **statute needs to be revised** to make clear, at a minimum, that whatever its application may be to other forms of alternative dispute resolution, it does not apply to mediation. The general Evidence Code provisions on mediation confidentiality govern. The staff would go further, however, and provide that the mediation confidentiality provisions govern other forms of alternative dispute resolution in the CID context as well.

There is precedent for this in the general statues governing confidentiality under the Dispute Resolutions Programs Act. Business and Professions Code Section 467.5 provides:

> 467.5. Notwithstanding the express application of Chapter 2 (commencing with Section 1115) of Division 9 of the Evidence Code to mediations, all proceedings conducted by a program funded pursuant to this chapter, including, but not limited to, arbitrations

and conciliations, are subject to Chapter 2 (commencing with Section 1115) of Division 9 of the Evidence Code.

The staff would replace Civil Code Section 1354(g)-(h) with a parallel provision:

~~(g) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), evidence of anything said or of admissions made in the course of the alternative dispute resolution process shall not be admissible in evidence, and testimony or disclosure of such a statement or admission may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.~~

~~(h) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), documents prepared for the purpose or in the course of, or pursuant to, the alternative dispute resolution shall not be admissible in evidence, and disclosure of these documents may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.~~

(g) Notwithstanding the express application of Chapter 2 (commencing with Section 1115) of Division 9 of the Evidence Code to mediation, alternative dispute resolution initiated by a Request for Resolution under subdivision (b), including, but not limited to, arbitration and conciliation, is subject to Chapter 2 (commencing with Section 1115) of Division 9 of the Evidence Code.

Informing Homeowners (Civ. Code § 1354(i)-(j))

Members of a homeowners association must annually be provided information about the availability of ADR for dispute resolution:

(i) Members of the association shall annually be provided a summary of the provisions of this section, which specifically references this section. The summary shall include the following language:

"Failure by any member of the association to comply with the prefiling requirements of Section 1354 of the Civil Code may result in the loss of your rights to sue the association or another member of the association regarding enforcement of the governing documents."

The summary shall be provided either at the time the pro forma budget required by Section 1365 is distributed or in the manner specified in Section 5016 of the Corporations Code.

The law implies that the summary is to be provided by the association, although this is not clear by reason of the statute being phrased in the passive rather than active mood. **That is easily remedied**:

> (i) ~~Members of the~~ An association shall annually ~~be provided~~ provide its members a summary of the provisions of this section, which specifically references this section.

The law does not indicate whether there are any consequences to the association for failure to provide the summary or for providing an inaccurate summary. The staff is not inclined to do anything other than leave the matter to ordinary enforcement mechanisms, just as any other violation of a statutory duty. Perhaps when we are done with this statute it will be clear and clean enough that a **summary may not be necessary**:

> (i) An association shall annually provide its members a ~~summary of the provisions of this section, which specifically~~ ~~reference~~s copy of this section.

The provision would then parallel subdivision (j):

> (j) Any Request for Resolution sent to the owner of a separate interest pursuant to subdivision (b) shall include a copy of this section.

Another interesting feature is that these two subdivisions are not quite consistent in their coverage. Section 1354(b) defines the scope of the statute as disputes involving "an association or an owner or a member of a common interest development". Subdivision (i) requires that a summary be provided to the "members" of an association. Subdivision (j) requires that a copy of the section be sent to an "owner of a separate interest". Perhaps the logic is that a member doesn't need a copy since the member receives a summary, but an owner needs a copy because the owner does not receive a summary. That assumes, of course, that members and owners are different folks. Even so, is it intended to distinguish between a "member of a common interest development" and a "member of an association"? Compare subdivisions (i) and (j). Or between an "owner" and an "owner of a separate interest"? Compare subdivisions (b) and (j). Perhaps these mysteries can be unraveled, but the staff suspects they are embedded in the Davis-Stirling Act and **it would be a mistake to pick at this** single thread.

When the Commission considered some of these matters last year, the Commission's sense was that the types of CID disputes that have been identified are not necessarily amenable to standardized treatment. Different disputes may be more effectively resolved by one technique than another.

For example, mediation is not necessarily a panacea — it may be more a hindrance than a help in resolving issues in some circumstances. This is particularly true where one of the parties enters mediation without the intention of settling. In that case, the mediation simply becomes an impediment to resolving the dispute by adding to the time and cost of its resolution. Likewise, it may not be profitable to allow one homeowner to trigger a mediation over an issue that transcends the interests of the individual homeowner and affects the community generally, such as the appropriate level of maintenance assessments for the community.

The Commission thought that mediation ought not necessarily to be required as a prerequisite to use of other resolution mechanisms. The Commission asked the staff to consider ways of distinguishing among the cases in which mediation and other dispute resolution processes would be beneficial. That 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.

The Commission also asked the staff to 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. However, that might require changes to the arbitration process. For example, to ensure fairness, there would probably need to be an appropriate level of judicial review of the arbitrator's decision.

The Commission also was interested in exploring ways of getting information about dispute resolution opportunities to affected boards and homeowners. The Commission asked the staff to further develop the concept of a center or clearinghouse that people could look to for basic information such as how to get

a copy of the governing statutes and how to go about seeking an appropriate dispute resolution process.

Finally, the Commission was interested in investigating the concept of imposing some sort of personal responsibility on directors who violate basic procedural fairness 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.

These concepts are developed below.

One Size Doesn't Fit All

The Commission's sense was that a fixed regimen of alternative dispute resolution was probably inadvisable for the variety of types of problems and circumstances of the parties that arise in the common interest development process. To impose alternative dispute resolution in circumstances where there is no reasonable prospect that it will succeed hurts, rather than helps, matters.

The staff consulted with Gregory Weber, a law professor and a mediator with the California Center for Public Dispute Resolution. Prof. Weber indicates that mediation can be most successful where a number of key factors are present, including:

(1) Discernible issues.

(2) Potential areas for agreement (multiple issues helpful).

(3) Identifiable parties.

(4) Parties anticipate future dealings with each other.

(5) Relative balance of power between the parties.

(6) Realistic time frame for resolving dispute.

(7) External pressures on parties to reach agreement.

(8) Litigation a poor alternative.

Association-homeowner disputes would seem to be a match for many of these factors, although some may be problematic, including: (3) identifiable parties (board may be speaking for an individual or for a majority of homeowners), (5) balance of power, and (7) external pressures (although there may be some from within the community).

The main factor in successful mediation is the willingness of the parties to participate. Otherwise, some other system, such as arbitration, will provide a more appropriate dispute resolution mechanism.

One option to obtain more effective dispute resolution would be to create an ombudsman or some other governmental entity that could perform a preliminary evaluation of the dispute and determine whether it is appropriate to send the dispute to a particular form of alternative dispute resolution or simply allow normal litigational processes take their course. In the past, the Commission has not been interested in creating or expanding governmental bureaucracy in this way.

Something like that function could be done through the judicial system, perhaps, by trained personnel in the court clerk's office. But the staff's sense is that by the time the dispute reaches the court clerk's office, it will generally be too late for effective alternative dispute resolution. Its major value at that point is reducing the burden on the court system rather than effective problem solving.

Absent some sort of alternative dispute resolution traffic director, that function could be, and undoubtedly is, performed by mediators or other neutrals to whom a dispute comes. If it is clear early on that alternative dispute resolution will not work, the neutral involved should let the parties know and direct them to a more appropriate forum. Meanwhile, there will have been the wasted time and expense of preparation for an inappropriate form of ADR.

Perhaps the **existing California scheme is as good as we can do**, within the existing framework. That scheme requires as a prerequisite to litigation that the parties "endeavor ... to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration. The form of alternative dispute resolution chosen may be binding or nonbinding at the option of the parties." Civ. Code § 1354(b). The statute pretty much leaves things to the discretion of the parties to select the most appropriate form of ADR and to accept or reject the offer of ADR, depending (presumably) on the prospects for a successful resolution of the dispute. The staff has suggested that the statute be revised to make clear that the range of ADR options to be considered is broad. See discussion above of "ADR Prerequisite to Litigation. It would also help if the parties had ready access to information about ADR options and which type may be most appropriate to help resolve their particular dispute. See discussion below of "ADR Information".

Med-Arb Agreements

An alternative to encouraging the parties to select an appropriate form of ADR would be to require 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.

The Commission has looked into Med-Arb as a viable ADR scheme in the past, in conjunction with its work on mediation confidentiality. The Commission proposed legislation to make clear that if mediation does not fully resolve the dispute, the arbitrator may not consider any information from the mediation unless all of the mediation parties expressly agree before or after the mediation that the arbitrator may use specific information. The Commission made clear, however, that it intended neither to sanction nor prohibit Med-Arb agreements, but only to clarify how mediation confidentiality would apply in that context. See *Mediation Confidentiality*, 26 Cal. L. Revision Comm'n Reports 407 (1996).

Even this limited provision proved not to be enactable. The dispute resolution community had substantial concerns that use of the same neutral to both mediate and arbitrate a dispute would undermine the confidentiality and candor necessary to effective mediation.

The staff believes that **it would not be politically possible by statute to mandate a Med-Arb requirement** for CID disputes. That would not preclude the parties from agreeing to it, with an understanding of the consequences, if they saw fit to do so.

Improving Arbitration

There are concerns about arbitration as an appropriate dispute resolution mechanism. One means to make it more useful for CID disputes would be to address some of the perceived shortcomings of arbitration.

Complaints include:

(1) It is costly and time consuming.

(2) It does not toll the statute of limitations.

(3) An award is not reviewable for errors of law.

(4) The arbitration process is confusing to many lawyers, let alone lay homeowners.

(5) There is no assurance of arbitrator competence or fairness.

(6) The risk of being assessed attorney's fees on appeal makes arbitration an unacceptable option to both sides.

See also the comments of Donie Vanitzian, Exhibit pp. 4-7.

The statute of limitations concern can be readily dealt with. See discussion above of "ADR Prerequisite to Litigation". The law could also be revised to require disclosure of arbitrator background and to expand the scope of judicial review to include errors of law. However, these concepts have been very hot issues in the Legislature in recent years. It is conceivable legislation could be achieved if limited to CID disputes, although parties to the legislative process often take doctrinaire positions as a matter of principle.

A more intractable problem is the cost and complication of arbitration. While arbitration can be a means to avoid congested courts and get disputes resolved, it is not clear that it would generate a substantial cost saving in the CID litigation context. There are no data readily available. If the Commission decides it is worth expending resources to see if arbitration can be made a more viable remedy for CID disputes, we will first **need to review the basic economics** of it.

There are some options for funding alternative dispute resolution. See discussion below of "Funding the Cost of ADR". However, it is not clear that these options would be appropriately applied to funding the cost of arbitration of CID disputes.

Funding the Cost of ADR

Experience tells us that, to be effective, alternative dispute resolution — whether in the form of mediation, arbitration, conciliation, internal association process, etc. — should involve a neutral. However, a neutral costs money. In fact, persons active in the field have informed us that the more competent and effective the neutral — whether it be a private mediator or a larger operation such as JAMS — the more costly is the service.

Under existing law, the costs of alternative dispute resolution are borne by the parties. Civ. Code § 1354(b). This is a disincentive to the parties' willingness to engage in an alternative resolution process.

Low Cost Options

There are some low-cost options. County mediation centers, for example, may be readily accessible to the parties. We have received a number of suggestions on this:

(1) Jim Lingl has noted that, "Every county in California has some form of ADR center, funded at least in part by court filing fees and 'Garamendi' monies.

They could be [and in many cases currently are] the venue for CID mediations and arbitrations."

He is referring to the Dispute Resolution Programs Act (DRPA) — Business and Professions Code Sections 465-472.5. About half the counties participate in that program. We are seeking further information about the extent to which that program may be used for CID dispute resolution. We hope to have that information available by the time of the Commission meeting.

(2) Some county bar associations offer mediation services staffed by pro bono attorneys with mediation training. It is likely that many of these programs already fall under the DRPA aegis.

(3) Some communities have neighborhood mediation programs in operation. A few of our correspondents have suggested that this may offer a ready forum for common interest communities. Alternatively, common interest communities might be encouraged to develop this sort of program.

(4) Marjorie Murray has noted that some communities provide mediation services in connection with landlord tenant disputes, for example Conciliation Forums in Oakland, which works in conjunction with nonprofit fair housing groups to negotiate and mediate disputes. "This same model could be replicated to resolve property owner / association disputes."

Spread the Cost

Another approach would be to attempt to defray the cost of dispute resolution so that it does not fall so hard on an owner involved in a dispute with the association. This could be done either by creating a fund to cover the cost, or by shifting the cost from the individual to the association.

There are a number of possibilities for creating a dispute resolution fund. It has been suggested to the Commission, for example, that a fund could be established from penalties imposed for late filing of corporate documents and by using Community Development Block Grant money. The staff questions whether these sources of revenue would be sufficient.

A more stable source of funding could be established by a small annual assessment (e.g., $1 per residential unit per year). However, experience in California with an annual fee in similar contexts suggests that such a provision could be difficult politically to enact. Requiring all CID units in the state to contribute to a fund that benefits residents in a few dysfunctional communities is somewhat problematic.

In addition, there are logistical problems with collection, including Proposition 13 issues and state mandated local program issues if it is done through the property tax system. One approach would be for each association to impose the ADR fee as part of its regular assessment process and remit the fee to the Department of Consumer Affairs, which could ensure the availability of dispute resolution services for CIDs through the DRPA process. (However, not every county participates in DRPA.)

Alternatively, each association could collect the annual fee and establish an association reserve to fund any ADR used within that CID.

A more direct approach, with the same net effect, would simply be to **require the association to fund ADR** for disputes within its own community:

> 1354.
>
> (b) ... If alternative dispute resolution is accepted by the party upon whom the Request for Resolution is served, the alternative dispute resolution shall be completed within 90 days of receipt of the acceptance by the party initiating the Request for Resolution, unless extended by written stipulation signed by both parties. The costs of the alternative dispute resolution shall be borne by the ~~parties~~ association.
>
> ...
>
> (d) Once a civil action has been filed between an association and an owner or member of a common interest development, upon written stipulation of the parties the matter may be referred to alternative dispute resolution and stayed. The costs of the alternative dispute resolution shall be borne by the ~~parties~~ association. During this referral, the action shall not be subject to the rules implementing subdivision (c) of Section 68603 of the Government Code.

Of course, if a board is inclined to reject an ADR request now, it would be even more likely to do so if it were required to bear the expense of ADR. It might be necessary to mandate ADR on request by a homeowner.

ADR Information

A key element of any alternative dispute resolution scheme is to ensure that the parties are informed about the opportunities available to resolve their dispute short of hiring a lawyer and going to court.

Existing law requires that CID homeowners be given information about the ADR statute. See discussion above of “Informing Homeowners (Civ. Code § 1354(i)-(j))”. Whether the members will actually read the information is

debatable. And even if they do, will they know how to go about seeking the help of a mediator or a neighborhood dispute resolution process. The Commission has felt in the past that it is important to have a locus of information and resources that can help members (and boards) to cope with disputes that arise.

Such an information center can do more than just provide information about ADR resources. It can also help resolve disputes just by providing the parties with a copy of the Davis-Stirling Act, establishing their respective rights and responsibilities. We understand informally from the Nevada Ombudsman that about a third of the phone calls to that office are resolved simply by providing the complaining party with basic information about rights and obligations under Nevada's common interest development law.

It would be relatively inexpensive and quite cost effective to assign a governmental entity with responsibilities in the CID area the task of establishing an information center. The center could have an "800" number with prerecorded information options. The center could have an associated website. Its function would be to inform people about the governing law and about the availability of alternative dispute resolution processes. It would provide people a clear contact point where they could get information readily and inexpensively. The information could include a plain language 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.

Although the state budget is currently under stress, such an assignment to an existing agency could be politically feasible. The Attorney General's public inquiry unit, for example, already has oversight responsibility for some CID corporate functions. Informally, they have not reacted negatively to the concept of an information center assignment. Other possibilities for this function include the state Department of Consumer Affairs (which already administers the Dispute Resolution Programs Act), the courts or the Administrative Office of the Courts (which already administers court-annexed dispute resolution programs and appears to be quite well funded), the state Department of Fair Housing, and each county dispute resolution coordination office (if it has one under DRPA).

If the Commission is interested in further pursuing any of these options, the staff will **make additional inquiries in the relevant agencies**. This will be particularly important in light of the changed fiscal circumstances of the various entities.

A caveat about total reliance on technology. The state Department of Consumer Affairs maintains an extensive databank of ADR services available in each county under DRPA. However, our staff's attempts to access that information through the department's "800" number have yielded tedious and fruitless trips through voicemail purgatory. A better option appears to be the agency's website, although navigating that is not completely obvious to the uninitiated.

Small Claims Jurisdiction

The Commission has previously investigated possible expansion of small claims court jurisdiction to cover the types of disputes involved in common interest communities. The thought was that the small claims process could offer the opportunity for a relatively quick and neutral decision in an accessible and lawyer-free environment.

The Commission ultimately concluded this would not be a desirable direction for the law, for a number of reasons. Among the considerations were that intra-association disputes often involve complex issues that would change the character of small claims proceedings, that the types of equitable relief requested often would affect persons not party to the proceedings, that the temporary judges used in small claims proceedings were not equipped to handle the types of litigation that arise, and that the potential impact of equitable relief on property rights could far exceed the normal small claims jurisdiction and would seem to call for more substantial discovery, evidence, and legal representation protections than are provided in small claims proceedings.

Nonetheless, the Commission thought there might be an opportunity for an expanded role for the small claims court in assessment disputes. Assessment disputes tend to involve amounts within the existing jurisdiction of the small claims court, and are relatively straightforward in nature. The Commission decided to explore the possibility of requiring that assessment disputes be processed through small claims court.

The only reference we could find in the legal literature to use of the small claims court in the CID context in fact suggests use of small claims court for enforcement of delinquent assessments. See Sproul & Rosenberry, *Advising California Condominium and Homeowners Associations* § 4.19 at 170-71 (Cal. Cont. Ed. Bar 1991):

> To save associations the time and expense of bringing a civil action in [superior] court, their attorneys usually recommend that associations themselves bring actions on delinquent assessments in small claims court, if they are below the jurisdictional limits for small claims court ($5000 as of January 1, 1991 (CC §116.220)). A small claims action brought under CCP §§116.110-116.950 is often the fastest and most cost-effective method of collecting a delinquent assessment. In fact, because the small claims jurisdictional limits are likely to be well in excess of the amount of a regular assessment, a need to file a [superior] court action is probably indicative of negligence on the association's part in pursuing delinquent accounts.

However, the Small Claims Act contains limitations on frequency of use of the small claims court by a person. A person may not bring more than two cases exceeding $2,500 in any calendar year. Code Civ. Proc. § 116.231. Filing fees are also scaled — $20 per filing, unless 12 or more filings have been made within the previous 12 months, in which case the fee is $35 for each additional filing during that period. Code Civ. Proc. § 116.230(a). We do not know whether this would encompass the majority of CID assessment disputes.

Marjorie Murray has written to us that, "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."

In criticizing the California statute allowing the homeowner to demand alternative dispute resolution for assessment disputes (Civ. Code § 1366.3), Prof. Batchelder suggests that small claims court be used for disputes under $5,000. He concludes that, "The small claims system affords inexpensive and speedy justice and, although not preferable to a more peaceful solution as through mediation, at least avoids the costly game playing that can result from forced ADR." Batchelder, *Mandatory ADR in Common Interest Developments: Oxymoronic or Just Moronic?*, 23 Thom. Jeff. L. Rev. 227, 240 (2001).

The Commission may want to **consider proposing something like**:

> 1367.1. An action to enforce or contest a regular or special assessment governed by this title is within the exclusive jurisdiction of the small claims division of the superior court and is subject to all provisions of the small claims law, including jurisdictional limits, frequency of use, and appeals.
>
> **Staff Note.** Such a section would need to be prospective only, to avoid dismissal of actions pending on its operative date.

Association Decisionmaking Process

An alternative approach to dealing with disputes is to try to defuse them before they develop to the point of litigation. This can be done significantly by ensuring fair decisionmaking procedures within the association, so that the homeowner has some assurance that the homeowner's decision has been heard and fully considered by a decisionmaker acting in good faith. The Commission has been working on such procedures in connection with association adoption of operating rules and decisions involving improvements.

Would it be useful to impose some sort of procedural process on an association as a prerequisite to taking one of its members to court? Curtis Sproul, in his critique of the Section 1354 ADR requirements, argues that it would have been preferable for the Legislature to amend the Davis-Stirling Act to mandate that community associations follow prescribed notice and hearing procedures, with decisions based on written findings, before initiating most court enforcement actions. Recent statutes and reported decisions involving community associations already impose such requirements on community association disciplinary and covenant enforcement proceedings:

> Similar conclusions have been reached in recent reported decisions regarding the importance of according community association members notice and a hearing at the association level prior to instigating litigation. For example, in *Ironwood Owners Association v. Solomon*, the defendant owner was clearly in violation of the CC&Rs' landscape approval requirements, and yet the court of appeal chastised the plaintiff community association's board of directors and ruled in favor of the defendant on procedural grounds, namely the failure of the association to provide the accused with fair notice and hearing procedures prior to bringing the matter to court. The Legislature could have simply required that the Section 7341 procedures be followed in the types of actions covered by the ADR rules of Civil Code Section 1354.

Sproul, *Alternative Dispute Resolution for Common Interest Developments: Recent Amendments to Civil Code Section 1354 Fall Short*, 12 Cal. Real Prop. J. 28, 33 (1994) [footnote omitted].

The Section 7341 procedures Mr. Sproul refers to are the Corporations Code provisions regulating the process by which a nonprofit mutual benefit association may expel or suspend a member. These provisions already apply to common interest developments that are incorporated (which we believe are most of them) under the Nonprofit Mutual Benefit Corporation Law:

7341. (a) No member may be expelled or suspended, and no membership or memberships may be terminated or suspended, except according to procedures satisfying the requirements of this section. An expulsion, termination or suspension not in accord with this section shall be void and without effect.

(b) Any expulsion, suspension, or termination must be done in good faith and in a fair and reasonable manner. Any procedure which conforms to the requirements of subdivision (c) is fair and reasonable, but a court may also find other procedures to be fair and reasonable when the full circumstances of the suspension, termination, or expulsion are considered.

(c) A procedure is fair and reasonable when:

(1) The provisions of the procedure have been set forth in the articles or bylaws, or copies of such provisions are sent annually to all the members as required by the articles or bylaws;

(2) It provides the giving of 15 days' prior notice of the expulsion, suspension or termination and the reasons therefor; and

(3) It provides an opportunity for the member to be heard, orally or in writing, not less than five days before the effective date of the expulsion, suspension or termination by a person or body authorized to decide that the proposed expulsion, termination or suspension not take place.

(d) Any notice required under this section may be given by any method reasonably calculated to provide actual notice. Any notice given by mail must be given by first-class or registered mail sent to the last address of the members shown on the corporation's records.

(e) Any action challenging an expulsion, suspension or termination of membership, including any claim alleging defective notice, must be commenced within one year after the date of the expulsion, suspension or termination. In the event such an action is successful the court may order any relief, including reinstatement, it finds equitable under the circumstances, but no vote of the members or of the board may be set aside solely because a person was at the time of the vote wrongfully excluded by virtue of the challenged expulsion, suspension or termination, unless the court finds further that the wrongful expulsion, suspension or termination was in bad faith and for the purpose, and with the effect, of wrongfully excluding the member from the vote or from the meeting at which the vote took place, so as to affect the outcome of the vote.

(f) This section governs only the procedures for expulsion, suspension or termination and not the substantive grounds therefor. An expulsion, suspension or termination based upon substantive grounds which violate contractual or other rights of the

member or are otherwise unlawful is not made valid by compliance with this section.

(g) A member who is expelled or suspended or whose membership is terminated shall be liable for any charges incurred, services or benefits actually rendered, dues, assessments or fees incurred before the expulsion, suspension or termination or arising from contract or otherwise.

This provision could be adapted, as suggested by Mr. Sproul, to govern a decision by an association to take one of its members court. And it is quite possible that the opportunity to be heard concerning the dispute will be helpful in resolving it. If the Commission is interested, the **staff will further develop** this concept.

Director Liability

The Commission has expressed an interest in exploring the possibility of imposing some sort of personal responsibility on directors who violate basic procedural fairness in the governance of an association, particularly with respect to possible intransigence in dealing with dispute resolution. Such a sanction would need to be carefully considered so as not to create a further disincentive for homeowners volunteering to serve on boards.

The issue arises because the Commission has heard instances in which the board appears to be acting in bad faith with respect to a homeowner. It may be relatively rarely that this occurs, and we would not want to act in such a way as to cause problems for all associations because of the bad actions of a few individuals.

We have received a communication from Debora M. Zumwalt that, "In the scope of our representation of Associations, we see very few instances of Boards of Directors abusing their power. More often than not it is the non-Board member owners abusing the volunteer directors of the Association." Exhibit p. 12. She is concerned that increasing liability of board members would be devastating — it would not only discourage able and competent association members from serving on their boards, but would also discourage boards from taking aggressive action when necessary.

However, we have also received a copy of correspondence from Samuel Dolnick to the opposite effect. See Exhibit pp. 14-16. Mr. Dolnick details a number of incidents that have come to his attention in recent years working as a homeowners' ombudsman with the CAI-San Diego Chapter. They are all

documented situations in which the board abused its power, leaving the homeowner in the untenable position of having to go to court to obtain redress. "My experiences, working with homeowners and boards of directors, suggest that there are a greater percentage of abusive boards than there are boards that are being abused." Mr. Dolnick believes something needs to be done to level the playing field between board members and homeowners. "Why can't the homeowners have the ability to fine or discipline errant board members without going to court, exactly the same way as board members have the ability to fine or discipline members without going to court?"

The directors do owe a fiduciary duty to the members. See generally discussion in Sproul & Rosenberry, *Advising California Condominium and Homeowners Associations* § 6.11 (Cal. Cont. Ed. Bar 1991). Directors may be held personally liable for breach of their duty, although the association may provide insurance protection or indemnification to some extent. Id. at §§ 6.33, 6.35. Exculpatory clauses in an association's governing documents that purport to immunize directors from liability to members are disfavored by the courts. Id. at § 6.34.

Ms. Zumwalt argues that the law already contains sufficient protections for owners against runaway boards. There are safeguards in place to prevent boards form acting without due process. If a board member does not act within the scope of the board member's duties, does not act in good faith, or acts in a grossly negligent manner, there is recourse against that board member. She cites Civil Code Section 1365.7:

> 1365.7. (a) A volunteer officer or volunteer director of an association, as defined in subdivision (a) of Section 1351, which manages a common interest development that is exclusively residential, shall not be personally liable in excess of the coverage of insurance specified in paragraph (4) to any person who suffers injury, including, but not limited to, bodily injury, emotional distress, wrongful death, or property damage or loss as a result of the tortious act or omission of the volunteer officer or volunteer director if all of the following criteria are met:
>
> (1) The act or omission was performed within the scope of the officer's or director's association duties.
>
> (2) The act or omission was performed in good faith.
>
> (3) The act or omission was not willful, wanton, or grossly negligent.
>
> (4) The association maintained and had in effect at the time the act or omission occurred and at the time a claim is made one or

more policies of insurance which shall include coverage for (A) general liability of the association and (B) individual liability of officers and directors of the association for negligent acts or omissions in that capacity; provided, that both types of coverage are in the following minimum amount:

(A) At least five hundred thousand dollars ($500,000) if the common interest development consists of 100 or fewer separate interests.

(B) At least one million dollars ($1,000,000) if the common interest development consists of more than 100 separate interests.

(b) The payment of actual expenses incurred by a director or officer in the execution of the duties of that position does not affect the director's or officer's status as a volunteer within the meaning of this section.

(c) An officer or director who at the time of the act or omission was a declarant, as defined in subdivision (g) of Section 1351, or who received either direct or indirect compensation as an employee from the declarant, or from a financial institution that purchased a separate interest, as defined in subdivision (l) of Section 1351, at a judicial or nonjudicial foreclosure of a mortgage or deed of trust on real property, is not a volunteer for the purposes of this section.

(d) Nothing in this section shall be construed to limit the liability of the association for its negligent act or omission or for any negligent act or omission of an officer or director of the association.

(e) This section shall only apply to a volunteer officer or director who is a tenant of a separate interest in the common interest development or is an owner of no more than two separate interests in the common interest development.

(f) (1) For purposes of paragraph (1) of subdivision (a), the scope of the officer's or director's association duties shall include, but shall not be limited to, both of the following decisions:

(A) Whether to conduct an investigation of the common interest development for latent deficiencies prior to the expiration of the applicable statute of limitations.

(B) Whether to commence a civil action against the builder for defects in design or construction.

(2) It is the intent of the Legislature that this section clarify the scope of association duties to which the protections against personal liability in this section apply. It is not the intent of the Legislature that these clarifications be construed to expand, or limit, the fiduciary duties owed by the directors or officers.

These legal arguments are not completely responsive to the point, however. While a board member may theoretically be subject to liability in some circumstances, judicial action is not a practical remedy for the ordinary

homeowner. The potential for more immediate personal liability of an errant director could have a deterrent effect on board members.

The possibility has also been suggested of providing a sanction against a management intermediary that advises the board. Of course, if the board has been advised to act improperly, with resultant liability, the management intermediary would be liable to the association. That assumes, of course, that the board takes action against the management company. But if one assumes, as some of our correspondents do, that boards and management companies are acting in concert to deprive homeowners of their rights, then reliance on the board to obtain reimbursement from a management company is futile. The homeowners would be relegated to a derivative action. See Corp. Code § 7710.

In order for a personal sanction to be effective, it would have to be one that could not be insured against or otherwise indemnified by the association. Assuming it is probably the law anyway that liability of a director for bad faith actions cannot be insured against or indemnified, then it wouldn't hurt anything to make that clear.

It would also be necessary that the sanction be sufficiently strong to act as a deterrent to bad faith action, but not so strong as to deter service on the board at all. A fixed monetary penalty, within the limits of small claims jurisdiction, might be appropriate.

The circumstances in which such a penalty would be imposed should be clear and limited. Perhaps it should only apply in the cases we are immediately concerned about in this memorandum — the failure of the board to engage in good faith dispute resolution efforts.

There should be a substantial burden of proof on a person seeking to impose such a penalty. Otherwise, a board member would be subjected to unending frivolous actions.

The staff is not advocating it, but **such a sanction might look something like this**:

> 1354.1. (a) If the board of directors of an association acts in bad faith to reject a homeowner's Request for Resolution of a dispute under Section 1354, or if the board of directors accepts a Request for Resolution of a dispute but acts in bad faith in the dispute resolution process, each director who participates in the bad faith action is personally subject to a penalty of one thousand dollars ($1,000), payable to the homeowner. An association may not insure

against or indemnify a director for a penalty imposed pursuant to this section.

(b) An action to impose a penalty pursuant to this section may be joined with another action relating to the dispute. An action exclusively to impose a penalty pursuant to this section is within the exclusive jurisdiction of the small claims division of the superior court.

(c) In an action to impose a penalty pursuant to this section, the homeowner has the burden of proof of the director's participation in bad faith action by the board. The standard of proof is clear and convincing evidence.

(d) If multiple homeowners joined in the Request for Resolution of a dispute, each homeowner is entitled to an equal share of a penalty imposed pursuant to this section.

(e) A homeowner may not bring an action to impose a penalty pursuant to this section more than once in a calendar year.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

Exhibit

SELECTED PROVISIONS OF DAVIS-STIRLING ACT

Civ. Code § 1354. Enforcement of convenants and restrictions

1354. (a) The covenants and restrictions in the declaration shall be enforceable equitable servitudes, unless unreasonable, and shall inure to the benefit of and bind all owners of separate interests in the development. Unless the declaration states otherwise, these servitudes may be enforced by any owner of a separate interest or by the association, or by both.

(b) Unless the applicable time limitation for commencing the action would run within 120 days, prior to the filing of a civil action by either an association or an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a claim for monetary damages, other than association assessments, not in excess of five thousand dollars ($5,000), related to the enforcement of the governing documents, the parties shall endeavor, as provided in this subdivision, to submit their dispute to a form of alternative dispute resolution such as mediation or arbitration. The form of alternative dispute resolution chosen may be binding or nonbinding at the option of the parties. Any party to such a dispute may initiate this process by serving on another party to the dispute a Request for Resolution. The Request for Resolution shall include (1) a brief description of the dispute between the parties, (2) a request for alternative dispute resolution, and (3) a notice that the party receiving the Request for Resolution is required to respond thereto within 30 days of receipt or it will be deemed rejected. Service of the Request for Resolution shall be in the same manner as prescribed for service in a small claims action as provided in Section 116.340 of the Code of Civil Procedure. Parties receiving a Request for Resolution shall have 30 days following service of the Request for Resolution to accept or reject alternative dispute resolution and, if not accepted within the 30-day period by a party, shall be deemed rejected by that party. If alternative dispute resolution is accepted by the party upon whom the Request for Resolution is served, the alternative dispute resolution shall be completed within 90 days of receipt of the acceptance by the party initiating the Request for Resolution, unless extended by written stipulation signed by both parties. The costs of the alternative dispute resolution shall be borne by the parties.

(c) At the time of filing a civil action by either an association or an owner or a member of a common interest development solely for declaratory relief or injunctive relief, or for declaratory relief or injunctive relief in conjunction with a

claim for monetary damages not in excess of five thousand dollars ($5,000), related to the enforcement of the governing documents, the party filing the action shall file with the complaint a certificate stating that alternative dispute resolution has been completed in compliance with subdivision (b). The failure to file a certificate as required by subdivision (b) shall be grounds for a demurrer pursuant to Section 430.10 of the Code of Civil Procedure or a motion to strike pursuant to Section 435 of the Code of Civil Procedure unless the filing party certifies in writing that one of the other parties to the dispute refused alternative dispute resolution prior to the filing of the complaint, that preliminary or temporary injunctive relief is necessary, or that alternative dispute resolution is not required by subdivision (b), because the limitation period for bringing the action would have run within the 120-day period next following the filing of the action, or the court finds that dismissal of the action for failure to comply with subdivision (b) would result in substantial prejudice to one of the parties.

(d) Once a civil action specified in subdivision (a) to enforce the governing documents has been filed by either an association or an owner or member of a common interest development, upon written stipulation of the parties the matter may be referred to alternative dispute resolution and stayed. The costs of the alternative dispute resolution shall be borne by the parties. During this referral, the action shall not be subject to the rules implementing subdivision (c) of Section 68603 of the Government Code.

(e) The requirements of subdivisions (b) and (c) shall not apply to the filing of a cross-complaint.

(f) In any action specified in subdivision (a) to enforce the governing documents, the prevailing party shall be awarded reasonable attorney's fees and costs. Upon motion by any party for attorney's fees and costs to be awarded to the prevailing party in these actions, the court, in determining the amount of the award, may consider a party's refusal to participate in alternative dispute resolution prior to the filing of the action.

(g) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), evidence of anything said or of admissions made in the course of the alternative dispute resolution process shall not be admissible in evidence, and testimony or disclosure of such a statement or admission may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.

(h) Unless consented to by both parties to alternative dispute resolution that is initiated by a Request for Resolution under subdivision (b), documents prepared for the purpose or in the course of, or pursuant to, the alternative dispute resolution shall not be admissible in evidence, and disclosure of these documents may not be compelled, in any civil action in which, pursuant to law, testimony can be compelled to be given.

(i) Members of the association shall annually be provided a summary of the provisions of this section, which specifically references this section. The summary shall include the following language:

"Failure by any member of the association to comply with the prefiling requirements of Section 1354 of the Civil Code may result in the loss of your rights to sue the association or another member of the association regarding enforcement of the governing documents."

The summary shall be provided either at the time the pro forma budget required by Section 1365 is distributed or in the manner specified in Section 5016 of the Corporations Code.

(j) Any Request for Resolution sent to the owner of a separate interest pursuant to subdivision (b) shall include a copy of this section.

Civ. Code § 1366.3. Alternative dispute resolution for assessments

1366.3. (a) The exception for disputes related to association assessments in subdivision (b) of Section 1354 shall not apply if, in a dispute between the owner of a separate interest and the association regarding the assessments imposed by the association, the owner of the separate interest chooses to pay in full to the association all of the charges listed in paragraphs (1) to (4), inclusive, and states by written notice that the amount is paid under protest, and the written notice is mailed by certified mail not more than 30 days from the recording of a notice of delinquent assessment in accordance with Section 1367; and in those instances, the association shall inform the owner that the owner may resolve the dispute through alternative dispute resolution as set forth in Section 1354, civil action, and any other procedures to resolve the dispute that may be available through the association.

(1) The amount of the assessment in dispute.

(2) Late charges.

(3) Interest.

(4) All fees and costs associated with the preparation and filing of a notice of delinquent assessment, including all mailing costs, and including attorney's fees not to exceed four hundred twenty-five dollars ($425).

(b) The right of any owner of a separate interest to utilize alternative dispute resolution under this section may not be exercised more than two times in any single calendar year, and not more than three times within any five calendar years. Nothing within this section shall preclude any owner of a separate interest and the association, upon mutual agreement, from entering into alternative dispute resolution for a number of times in excess of the limits set forth in this section. The owner of a separate interest may request and be awarded through alternative dispute resolution reasonable interest to be paid by the association on the total amount paid under paragraphs (1) to (4), inclusive, of subdivision (a), if it is determined through alternative dispute resolution that the assessment levied by the association was not correctly levied.

DONIE VANITZIAN
ARBITRATOR
POST OFFICE BOX 10490
MARINA DEL REY, CALIFORNIA 90295

November 14, 2001

Mr. Natanial Sterling
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, California 94303-4739

THE TEMPLE OF BLAME
AND
SCAPEGOATING THE U.S. COURT SYSTEM

Dear Mr. Sterling,

After reading the California Law Revision Committee's (CLRC) latest justification for a paycheck, i.e., Memorandum 2001-94, all I can say is that I am in the wrong business. How does one secure a position on the CLRC board? At least a year in the making and said Memorandum is seriously flawed and misses the mark.

I want to thank the CLRC for the laugh. It's truly been a while since I've laughed this hard. Quote from your Memorandum 2001-94 surpasses anything Saturday Night Live or Mad TV could come up with: ***"Considering that homeowners associations are governed by volunteers who may not be legally sophisticated, some association board members may not be aware of the existing fairness requirements or how to adequately implement them."***

These are ***not*** volunteers in the sense of the charity-volunteer you make it sound, they are domineering autocrats who are advised to run as a "slate" by their overpaid industry lawyers in order to gain and keep control/power over all others in the association. It is a sophisticated network of persons and their aiders and abetters who assure their group rotates and stays on the board. Let me know when you want to see the level of legal sophistication that our homeowner association has been able to ***purchase*** and use ***against homeowners.*** Gentlemen, your concerns appear unsophisticated and misplaced and your "Proposed Legislation" is seriously flawed for a number of reasons. (This is not the appropriate forum for elaboration on those flaws).

It is bad enough when a court of law interprets common interest development (CID) law in its own light, but arbitrators and mediators can not only bring their own personal experiences with them to the CID bargaining table, they can, and often do bow to pressures and/or influence from the parties before them.

As I wrote in my May 7, 2001 correspondence to you, ***neither mediation or arbitration tolls the statute for the complainant, neither is free, and neither judge must take precedents into account***.

According to the NASD Mediation Rules, "the submission of a matter for mediation **shall not stay** or otherwise delay the arbitration of a matter pending under this Code" (10403), it also **does not stay** the Complainant's action of Mediation or Arbitration in the "real world" **nor does it stay a "real court"** case merely because mediation or arbitration is being utilized.

According to the NASD Code of Arbitration Procedure, which incidentally, an independent Arbitrator and/or Mediator does NOT have to follow or be a member of, "no dispute, claim or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy." In fact, this Code makes clear that **it in no way extends any applicable statue of limitations.** Even following the NASD Code of arbitration procedure, this **leaves CID homeowners in a weakened position** with respect to filing lawsuits as their last resort or only recourse. Which is usually the case.

Add to this, the reason industry and other corporate entities push for arbitration (let alone mandatory and binding arbitration) is the fact that they convince the complainant to forgo any chance of appeal. That's right, the complainant must sign-off on pursuing any appeal they might otherwise have had access to and the decision, whatever it may be, is binding.

The CLRC's recommendations for Mediation and/or Arbitration are a stupendously colossal waste of time for the CID homeowner!

But, perhaps the most egregious abuse committed against CID homeowners as a class separate and aside from "real" homeowners, is the CLRC's ***insistence*** that mediation and/or arbitration take place at all. Why funnel CID homeowners away from their immediate right to have access to the U.S. Court system at all? Why not ***open the gates and make it easier for CID homeowners who continue to suffer injustice at the hands of their HOA boards and the California legislature, and management companies, to be able to seek justice in a REAL court of law that their tax dollars have already funded.*** Why the fear?

Forcing even one CID homeowner to endure a mediation or arbitration process is to ignore the ***cri de coeur*** of all CID homeowners. Subjecting these homeowners to a process no other homeowner in the State of California is ***forced*** to endure, exceeds the bounds of what the CLRC can and cannot do.

Understand that there is absolutely ***No*** mandate in the law, that says either mediation or arbitration must utilize "due process" or even consider evidence put before them in rendering a decision. If the CLRC wanted to "do something" for CID homeowners, they could have proposed the imposition of ***penalties against boards that disobey the existing laws*** and give homeowners the same rights as board members.

What is truly remarkable is that CID homeowners spend their precious time away from family and work in order to write the CLRC, and frankly it appears as if the CLRC doesn't give a damn. Again the problems are evident:

- Neither Mediation nor Arbitration Tolls the Statute for the Claimant

- Often as a condition of entering into either Mediation or Arbitration, the Claimant is made to sign a "binding" agreement, and an agreement that states the Claimant "forfeits any chance of Appeal" and agrees with the judgment

- No Caps on Costs for Mediator or Arbitrator Fees

- Neither Mediation nor Arbitration is ***Per Se*** Free to the CID Homeowner-Complainant

- No Mandatory Rule that Due Process or Precedents be taken into Account During Proceedings, Deliberation, and/or Rendering of Judgment

- No Mandatory Disclosure of Educational Requirements for Mediators or Arbitrators

- Both Processes are Confusing for the CID Homeowner-Complainant

- The Pressure on Homeowners of being "Forced" to Choose Mediation or Arbitration to Resolve Their Dispute, Places Homeowners in an Inferior Position to Exercise their Rights in a Court of Law and in General

- Homeowners Can and Do, End Up Paying the Respondent's Costs

Instead of recommending ***more circuitous laws***, the CLRC could have implemented what the CID homeowners have been asking for since the beginning of the ill-

fated and industry-biased Davis-Stirling Act:

> *Provide any member of a CID homeowner association who sustains economic loss because the association failed to retain or provide access to documents and records, to recover compensatory damages, up to $5,000 (or whatever the limit of Small Claims Court may be at the time of said Bill).*
>
> *Make it mandatory that the board of directors of the association retain all documents and records of the association, including, but not limited to, records of proposals, contractual agreements, correspondence, tax filings, receipts, checks, canceled checks, ledgers, accounting books, ballots and other voting instruments, and voting related records, for a period of no less than seven years.*
>
> *Make the board of directors of the association provide all members of the association with the same access to the documents and records specified in subdivision (a) as members of the board, including the right to view and copy all such documents and records.*
>
> *Documents and records shall be made available for viewing and copying within 10 days of receipt of the written request of the member.*
>
> *A member of the association who has sustained economic loss because of the association's violation of subdivision (a) or (b) may recover compensatory damages therefor, not to exceed five thousand dollars ($5,000).*

The CLRC could have assisted CID homeowners in obtaining copies of their HOA insurance policies, but the CLRC didn't think this was important. To date, regardless of what the Davis-Stirling Act states, homeowners must pay and keep paying for documents they should be entitled to receive ***in toto***. That is, if they are able to view them at all. Why doesn't the CLRC do something useful for the homeowners instead making ridiculous recommendations of nonsense.

Finally, the next thing the CLRC can do, is remove from its own board, any member of the CLRC who has a conflict of interest with CID laws or execution thereof.

Sincerely,

Donie Vanitzian

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SHERYL J. ROSANDER OF COUNSEL

September 10, 2001

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: June 29, 2001 Meeting of the California Law Revision Commission

Dear Members of the Commission:

We have reviewed the minutes of the above-referenced meeting and respectfully request that the Commission consider our comments regarding Study H-851, Nonjudicial Dispute Resolution Under CID Law. Our firm has exclusively represented California homeowner's associations since its inception fourteen years ago. Debora Zumwalt has devoted her past seven years of practice with the firm exclusively to assisting our Association clients in collecting delinquent assessments from Association members. Our firm has handled thousands of assessment collection matters.

The Commission considered this issue at its June 29, 2001 meeting. The minutes of the June 29, 2001, meeting, at pages 5-6, state:

> . . . the Commission will consider the possibility of improving lien foreclosure procedures, such as by imposing a mediation requirement, by precluding lien imposition for fines (as opposed to assessments), by limiting use of nonjudicial foreclosure techniques for non-assessment liens, or some other technique. The Commission will also consider whether there may be an appropriate means of tempering board action, either by some sort of personal responsibility of directors or liability of the association. This would need to be done in such a way as not to discourage able persons from serving on the board or to discourage the board from acting effectively when the need arises.

Contemplated Mediation Requirement

In 1997, Section 1366.3 was added to the Civil Code, providing an alternative dispute resolution procedure for assessment issues. This Section recognizes the importance of Associations' assessment income as it requires owners who dispute their assessment obligation to pay their assessment debt in full, under protest. In such a case, the Association must then advise the owner of the right to resolve the matter through alternative dispute resolution. This procedure is in place and provides owners with the opportunity for mediation. We strongly believe that imposing additional mediation requirements would impede, rather than improve, lien and foreclosure procedures.

Civil Code Section 1367 provides Associations with nonjudicial foreclosure as a very powerful and necessary remedy to enforce the assessment obligation. Associations are nonprofit organizations whose only source of income is often assessments paid by their members. Without this income, Associations cannot perform their many duties owed to the entire Association membership. Please do not be swayed by the sensational stories of out-of-control homeowner's associations. It is rarely the case when a Board unlawfully forecloses on an owner.

As an alternative to foreclosure, Associations can obtain personal judgments against delinquent owners. However, it is a rare case when an Association obtains a judgment against an owner and the owner pays that judgment voluntarily. Most often, the Association must expend funds to enforce judgments via wage garnishments or other means. In our experience, nonjudicial foreclosure is a much more effective remedy for Associations. The risk of losing their home due to nonpayment of assessments catches a delinquent owner's attention much better than a judgment entered against him or her, and most often prompts payment without the Association proceeding to actual foreclosure. The bankruptcy laws provide protection to those owners who honestly cannot afford to pay their assessments. Although bankruptcy is a last resort, in our experience most Association Boards will work out payment arrangements with delinquent owners to avoid foreclosure.

The nonjudicial foreclosure process has built-in procedural safeguards and due process requirements. Before the Association can take the first step of recording a lien against an owner's property, the Association must provide the owner, via certified mail, with a demand including a breakdown of the delinquency and a summary of the Association's collection procedures.[1] After a lien is recorded, there is a thirty-day waiting period before the lien may be enforced by foreclosure.[2] Following recordation of the Notice of Default, there are further notice requirements including two mailings and posting of the foreclosure documents at the owner's property. There is also a 90-day redemption period before a sale can be set[3]. There simply is no need to impose additional mediation requirements. Additional requirements would serve to allow the owner to delay the process, and cause the Association to incur more attorney's fees, which will ultimately be passed on to the owner[4].

[1] Civil Code Section 1367(b).

[2] Civil Code Section 1367(e).

[3] Civil Code Section 2924(b), 2924(c).

[4] Civil Code Section 1367.

California courts have held that maintenance assessments are covenants running with the land which bind all owners of the property with a duty and legal obligation to pay these assessments[5]:

> It is undisputed that the maintenance assessments are in fact covenants running with the land and the declaration of covenants, conditions and restrictions include a provision that each homeowner was to pay his or her proportionate share of maintenance fees. The intent that the Cerro de Alcala covenants were to run with the land was expressly manifested in the deed thorough which [Defendant] Burns acquired title. Further, maintenance assessments "touch and concern the land" as the payments go directly to the maintenance of the grounds and the making of necessary repairs. Finally, the covenants specifically bound all successors without distinction as to how the property is acquired.

Cerro de Alcala, at 4.

The most common assessment dispute arises where the owner does not wish to pay assessments because he or she has a separate dispute with the Association. California courts have held that an owner may not withhold or set off an assessment obligation.[6] To allow an owner to set off the obligation to pay assessments against a performance obligation of an association would erode and contradict the intent of Sections 1366 and 1367 of the Civil Code. The Court in the Park Place Estates case specifically held:

> These statutory provisions reflect the Legislature's recognition of the importance of assessments to the proper functioning of condominiums in this state. Because homeowners associations would cease to exist without regular payment of assessment fees, the Legislature has created procedures for associations to quickly and efficiently seek relief against a nonpaying owner. Permitting an owner to broadly assert the homeowners association's conduct as a defense or "set off" to such enforcement action would seriously undermine these rules.

Park Place Estates, at 432.

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[5] Cerro de Alcala Homeowners Association v. Burns, 169 Cal. App. 3d Supp. 1 (May 1985).

[6] Park Place Estates Homeowners Association v. Naber, 29 Cal. App. 4th 427 (1994).

Given that the obligation to pay assessments is an *independent covenant* which binds the individual owner, there are very few valid issues an owner could raise in dispute of the assessment obligation. These may have to do with the period of ownership or perhaps accounting questions. As set forth above, there is a statutory mediation procedure in place to address any valid issues that are raised.

Further, in 1997, the United States District Court for the Southern District of California held that the Federal Fair Debt Collection Practices Act[7] applies to the collection of Association assessments.[8] The provisions of this Act provide additional safeguards against unfair debt collection practices, and provide for additional procedural safeguards, such as debt verification at the owner's request.[9] Association practitioners are reluctant to proceed with collection efforts when it is not clear that the debt they are collecting is valid.

To summarize, existing law provides numerous safeguards against improper foreclosure proceedings. Additional mediation requirements would simply allow owners to delay the process, increase fees to the Association which would ultimately be passed on to the delinquent owner, and would most often not serve a valid purpose.

Contemplated Limitation of Lien Imposition for Fines

The Commission next states that it will consider the possibility of precluding imposition of liens for fines. In 1997, Civil Code Section 1367 was amended to provide:

> (c) except as indicated in subdivision (b)[10], a monetary penalty imposed by the Association as a disciplinary measure for failure of a member to comply with the governing instruments, except for the late payments, may not be characterized nor treated in the governing instruments as an assessment which may become a lien against the members subdivision interest enforceable by the sale of the interest under sections 2924, 2924(b), and 2924(c). (Emphasis added.)

[7] 15 U.S.C. Section 1692a et.seq.

[8] Thies v. Wyman, 969 F. Supp. 604 (1997).

[9] 15 U.S.C. Section 1692g.

[10] The exception is a monetary penalty imposed by the Association as a means of reimbursing the Association for costs incurred by the Association in the repair of damage to the common areas and facilities for which the member or the member's guests or tenants.

This 1997 amendment prevents the Association from commencing nonjudicial foreclosure for monetary penalties (except for reimbursement for damages to the common area). Thus, any enforcement action taken by an Association regarding monetary penalties is subject to judicial review in that the Association would have to pursue the issue by way of judicial foreclosure or a lawsuit for a personal judgment. There is even more protection afforded owners with last year's amendment to Civil Code Section 1363. This Section imposes notice and hearing requirements with which a Board must comply before taking disciplinary action against a member.[11]

Associations are vested with the duty of enforcing the Association's governing documents, which can sometimes be very difficult to do. Because fines cannot be included in nonjudicial foreclosure proceedings along with delinquent assessments, Associations must often simply allow fines to accrue on an owner's account unless the fines reach a level which is high enough to justify taking legal action in the way of a personal judgment to collect them, or bringing an enforcement lawsuit against the owner. It would not be in the best interest of common interest developments to further hinder Associations' ability to enforce their governing documents.

Contemplated Imposition of Director or Association Liability

Finally, minutes of the June 29, 2001, meeting state that the Commission intends to consider whether there is an appropriate means of tempering board action, either by some sort of personal responsibility of directors or a liability of the Association. The minutes state that this would need to be done in such a way as not to discourage able persons from serving on the board or discouraging the board from acting effectively when the need arises.

In the scope of our representation of Associations, we see very few instances of Boards of Directors abusing their power. More often than not it is the non-Board member owners abusing the volunteer directors of the Association. A much bigger problem that we see is finding volunteers to serve on Boards of Directors. To increase liability of Association Board members or of the Association would be devastating. To do so would not only discourage able and competent Association members from serving on their Boards of Directors, but would also discourage Boards from taking aggressive action when necessary.

The law already protects owners from runaway Boards. There are numerous safeguards in place which prevent Boards from taking actions without due process. For example, liability of a volunteer officer or director is only limited if his or her acts were performed within the scope of their duties and in good faith, was not willful or grossly

[11] Civil Code Section 1363(h).

negligent, and the Association maintains a minimum level of insurance.[12] Thus, if a Board member does not act within the scope of his or her duties, does not act in good faith or act in a grossly negligent manner, there is recourse against that Board member.

We thank you for your consideration of our comments on the contemplated changes in the law regarding common interest developments, and hope that the Commission finds this information useful. We feel that the issues the Commission raises are adequately addressed through existing law, and that the contemplated changes could severely and adversely affect Associations' ability to perform their duties. Please contact us if you have any questions or would like either or both of us to attend hearings for discussion of these issues.

Sincerely,

EPSTEN GRINNELL & HOWELL, APC

Debora M. Zumwalt

Jon H. Epsten

DMZ:slm

[12] Civil Code Section 1365.7.

ATTACHMENT #2

SAMUEL L. DOLNICK
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November 20, 2000

Attorney General Bill Lockyer
Department of Justice
Public Inquiry Unit
P.O. Box 944255
Sacramento, CA 94244-2550

RE: Violations of California Codes and Governing Documents by Board members of Common Interest Communities.

Dear Attorney General Lockyer:

As a condominium homeowner who was involved as a board member, is involved in the San Diego Chapter of Community Associations Institute (CAI), and involved as a member of the CAI California Legislative Action Committee I find it necessary to bring to your attention a serious problem in the operation of common interest communities.

The problem is the relationship between the individual/group of homeowners and their board of directors, when these directors violate the Corporations Code, Civil Code, other sections of the California Codes and the associations governing documents regulating common interest communities.

The laws referred to allow the directors, when the governing documents provide, to fine or discipline in some fashion those homeowners who violate the governing document or the California Codes. However, when these board members themselves violate these same documents or laws, the homeowners have no venue to fine or discipline these board members without going to court. Let me describe some actual instances that have come to my attention over the past twelve years working as a homeowner's "ombudsman" with the CAI-San Diego Chapter.

EXAMPLE: A homeowner is cited for a violation. The homeowner requests mediation as provided by law. The board can refuse mediation (its in the law). The only alternative left to the owner is to go to court with the resultant court costs.

EXAMPLE: When an owner violates the Declaration, bylaws or rules and regulations, the board, if the documents so state, can fine the owner or discipline the owner in other ways. The board can enforce its action against the owner in Small Claims Court. However, when the board as a group, or individual board members violates these same documents, the owners cannot fine or discipline the board as a group or individual board members nor can they go to Small Claims Court to request justice. The only alternative is for the owner to go to Superior Court with the resultant high costs.

My main concern is that currently there is no statutory remedy to homeowners when boards of directo4rs are abusive to homeowners and when these boards abuse the governing document or state codes to favor themselves in a manner that is not allowed to other owners. My experiences, working with homeowners and boards of directors, suggest that there are a greater percentage of abusive boards than there are boards that are being abused. This is why in the past I've tried to present arguments and data for a common interest ombudsman, to be provided in law, but to no avail.

Please allow me to list just a few documented situations where the board of directors abused its powers leaving homeowner(s) powerless to get justice.

1. President and vice-president of board enclosing their carports to make a full garage in violations of the Declaration of Conditions, Covenants and Restrictions (CC&Rs). When other homeowners did this they were sent violation notices and forced to remove the garage additions. Homeowners asked for mediation. The board refused. The homeowners dropped the issue because they did not have sufficient money to go to court. President and vice-president still have their garages.

2. Board places special assessment for roofs for a vote before the membership as more than 5% of the gross budgeted amount for expenses is needed. Membership votes to approve the special assessment on a ballot that stated that a certain amount of money is due each month for four years. The amount of money assessed to each unit is equal. Nothing in the ballot said anything about a discount, of the special assessment is paid early.

   After one year, the board votes that a 5% discount will be given to any owner who pays the remaining three year balance in a lump sum. Four of the five board members take advantage of the discount as well as a few other owners. Homeowners who do not have sufficient money to take advantage of the discount protest that the CC&Rs are being violated as all assessments; regular and special are to be assessed on an equal basis. They also claimed that the membership vote is being subverted, as the membership did not vote a 5% discount for lump sum payment. Homeowners ask for a hearing, which was denied; they ask for mediation, which was held. Three of the five board members attended the mediation and they said that since a majority of the board was present, they had the power to sign an agreement if one was arrived at. When an agreement was ready to be signed, the three board members then stated they would have to confer with the other two before they could sign. They left after telling the mediator they would notify him of the decision. The board members never called the mediator back. Where do the owners go now? Those who did not pay the lump sum will have additional money to pay for the roofs as the 5% discount creates a shortfall of the contract price. To go to court costs money that the homeowners don't have.

3. Two board members take unassigned parking spaces as their own on a continual basis. Unassigned parking spaces were always on a first come first serve basis as per resolution by the board of directors. Owners object and request mediation; the board refuses. End of case, as owners cannot afford to go to court.

4. A board member objects to a deficit budget presented by the treasurer. Condo manager agrees with board member. Treasurer states that deficit is made up by transferring money from reserve fund. Treasurer says that he is willing to change some numbers, because he has experience in this, so that everything comes out balanced. Original board member objects. Board overrules this single board member. Board member writes to State Attorney General with documentation and certified copy of minutes asking for action because of violation of Davis-Stirling Act. Attorney General writes back that board member should hire an attorney to sue the board. Again, this is an impossibility because of the amount of money necessary to go to court.

5. Association, according to the governing documents has a specified number of parking spaces that may be rented. Board decides this is not sufficient. They take common area street space to create more rental parking spaces. These new rental parking spaces are not on the Condominium Parking Plan. Homeowners object, not for the need for more rental parking spaces, but to the fact that

common area is taken but the board, while the documents state that the membership has to vote on any taking of the common area. The board does not have the authority to do this on their own. Board says their attorney says board action is permissible under the rules and regulations clause of the governing documents. Four other attorneys disagree. Board refuses to rescind its prior action and put the issue for a vote of the membership. Now it appears a great deal of money will have to be expended to take the case to court.

6. One member of a five member board constantly question monetary action of the board majority as being in violation of the governing documents and state statutes. President, with a majority of the board, refuse to recognize the board member to speak at board meetings. In an executive session, at which the complaining board member is excluded, board votes this board member off of the board. Board refuses to recognize that this is beyond their authority, the only the membership has this power as the membership elected this board member. The board then doesn't allow this board member to take her seat at the next regular board meeting. Association attorney will not respond to calls from this board member because board has not given the member authority to call the attorney, plus the statement by the attorney that since he represents the Association, it would be a conflict of interest to talk to the board member. What statutory remedy does this board member have without spending pockets full of money to go to court and the amount of time it will take before a court decision is rendered?

More situations can be cited, but the above should be sufficient to prove the point that homeowners currently do not have any reasonable remedy when the board of directors themselves violate the governing documents or the State codes.

One of the remedies attorneys cite is that homeowners have the power to recall any member of the board or the full board. As most documents require cumulative voting, it is almost impossible to recall only one or two board members. All board members must be recalled, even the ones who try to adhere to the documents. This again is not a viable or realistic option.

Something must be done Mr. Lockyer to level the playing field between board members and the homeowners. Why can't the homeowners have the ability to fine or discipline errant board members without going to court, exactly the same way as board members have the ability to fine or discipline members without going to court?

Any help you can give me so that I can help others will be sincerely appreciated. Also any help I receive will also help the thousands of homeowners living in common interest communities. Thank you for your attention to this matter.

May I hear from you?

Sincerely yours,

Samuel L. Dolnick
Homeowner