Study H-851 February 25, 2002

First Supplement to Memorandum 2002-10

Nonjudicial Dispute Resolution Under CID Law:
Alternative Dispute Resolution (Comments on Memorandum)

This supplemental memorandum addresses a number of issues discussed in Memorandum 2002-10, relating to alternative dispute resolution in the common interest development context. In addition to further staff comments on various issues, this supplement analyzes comments we have received from Lester H. Thompson. Mr. Thompson's comments are attached as an Exhibit.

BACKGROUND

Memorandum 2002-10 notes that the Commission has previously considered and rejected the concept of developing a governmental entity to superintend the dispute resolution process. Mr. Thompson observes that there are many reasons why governmental oversight of CIDs is necessary, and not just to manage the dispute resolution process. Exhibit pp. 1-2.

The staff thinks that if governmental oversight is established for other reasons, it would be appropriate for the Commission to go back and further assess whether dispute resolution functions should be lodged with the governmental entity. And in fact, the Commission itself may well recommend, once it has explored other problem areas of CID law, that governmental oversight should be established. However, for now the Commission has decided to prioritize consideration of dispute resolution issues, and for that purpose has concluded that it will focus primarily on improvement of existing processes rather than creation of new oversight entities or functions.

GENERAL POLICY CONSIDERATIONS

Mr. Thompson repeats a concern others have expressed — there is an inherent inequality of financial strength between a homeowner and the association. The Commission has viewed this situation as an argument in favor of ADR over litigation. But Mr. Thompson sees it as an impediment to ADR as well — the homeowner "cannot in the majority of instances afford simple

mediation costs let alone the cost of legal counsel. In many instances the dispute could involve a cost of $1,000.00, for example, but is not challenged by any member when the cost of any alternative dispute resolution would exceed that amount and not be worth the expense or effort." Exhibit p. 3. He offers suggestions to make ADR more friendly to all parties. These are discussed below.

SOME STATISTICS

Incidence of Problems in CIDs

Memorandum 2002-10 reports a fairly high incidence of CID complaints in Nevada. More recent information provided by the California Research Bureau indicates that the complaint rate to the Nevada Ombudsman has not declined below about 1,000 per month.

Resolution of Problems by ADR

The Community Associations Institute indicates that 25% of CIDs in the United States have used ADR at least once. Of these, 90% have found arbitration or mediation effective. The State of Hawaii's Neighborhood Justice Center reportedly has an ADR success rate of 85 percent in resolving CID disputes.

EVALUATION AND IMPROVEMENT OF EXISTING LAW

Communication Between Board and Homeowner

In Memorandum 2002-10, the staff expresses skepticism about the prospects for providing confidentiality of communications in a homeowner v. board dispute. One perhaps achievable means to this end is suggested by Lester Thompson — the board could delegate a representative to meet with the homeowner in a confidential attempt to resolve the dispute. "In many instances the board refuses to have any communication with the member regarding the dispute at the advice of the association attorney. That stops any communication and forces legal proceedings which in many cases could possibly be avoided." Exhibit p. 4. The staff thinks this concept is worth exploring.

Mr. Thompson also suggests that all attorney opinions obtained by the board be made available to members. Apparently in response to potential concerns about privilege and confidentiality, he would except from this requirement attorney opinions concerning litigation. Presumably, that would help equalize

the positions of the board and members, and promote the openness necessary for dispute resolution.

Procedures Provided in Governing Documents

In Memorandum 2002-10, the staff suggests a simple default procedure for an aggrieved homeowner to present the matter in writing to a single member of the board. Mr. Thompson proposes an analogous procedure, involving a face to face meeting. See discussion immediately above.

ADR Prerequisite to Litigation

Statute of Limitations

In Memorandum 2002-10 the staff proposes tolling the statute of limitations during the ADR period (up to 120 days). There is a possibility that parties wishing to sue would routinely file an ADR request merely to extend the statute of limitations, rather than to engage in meaningful ADR. This prospect does not disturb the staff — the tolling period is limited, and relieving the pressure to file an action may actually facilitate ADR.

Type of ADR

Memorandum 2002-10 mentions "conciliation" as an ADR option. The staff is not sure that the concept of conciliation is really distinct from mediation, but the term is in common use in various contexts, including family law and labor law.

Manner of Service

In Memorandum 2002-10, the staff indicates the need to liberalize the manner of service of a Request for Resolution. In addition to first class mail, the Commission may want to consider other options, such as Express Mail, delivery service, FAX, and other means reasonably calculated to give actual notice. See, e.g., Code Civ. Proc. § 1013 (manner of service by mail, Express Mail, or FAX).

Rejection of Request for ADR

Lester Thompson proposes that an association should not be permitted to refuse a homeowner's request for ADR. Exhibit p. 4. The staff has argued in Memorandum 2002-10 that mandatory ADR may be counterproductive, and other means of encouraging ADR (such as litigation disincentives) more fruitful.

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

Existing law, both in the Dispute Resolution Programs Act and in the Davis-Stirling Act, provides for confidentiality of arbitration communications. This provision would be preserved in the staff's proposed reformulation of the law. However, an argument can be made that confidentiality is not necessary for arbitration to be an effective remedy. There is no need to encourage open and frank communications in arbitration; moreover, confidentiality makes judicial or other review of the arbitration impossible.

OTHER AVENUES FOR IMPROVEMENT OF DISPUTE RESOLUTION

One Size Doesn't Fit All

The Commission has previously considered and rejected the possibility of having a governmental entity such as an ombudsman involved in referring a CID dispute to an appropriate forum for resolution. Lester Thompson suggests that the Attorney General could perform a useful function in this respect, such as by selecting a mediator or arbitrator if the parties are unable to agree. Exhibit p. 4.

Improving Arbitration

Memorandum 2002-10 includes a discussion of concerns about arbitration, including its cost and arbitrator quality. Mr. Thompson makes a number of suggestions on this matter, including establishment of minimum qualifications for mediators and arbitrators, judicial review of arbitration awards, funding mediation and arbitration through affordable fees shared by the parties, and elimination of an award of attorneys fees in arbitration. ("This risk is a further deterrent to an owner to seek justice.") Exhibit p. 4.

The Commission should be aware that there are ongoing efforts to improve arbitration generally. For example, the law now requires the Judicial Council to adopt ethical standards for arbitrators. Code Civ. Proc. § 1281.85. However, with respect to judicial review, there are potential preemption issues under the Federal Arbitration Act.

Funding the Cost of ADR

Low Cost Options

Memorandum 2002-10 lists a number of low cost ADR options that could help make ADR affordable in the CID context. An additional option that may be

feasible for large CIDs is to require designation of an association ADR officer. The officer could receive appropriate training and be available on site to provide appropriate information to the parties concerning low cost ADR availability in the community, or even possibly to provide mediation services.

Spread the Cost

With respect to concerns about imposing an annual fee on CID units for dispute resolution, Lester Thompson argues that CID problems are a statewide concern, and a "door tax" to establish oversight for the benefit of all CID owners is warranted. Exhibit pp. 1-2.

ADR Information

Mr. Thompson argues that the Attorney General is the appropriate locus as an ADR information center.

Also, the staff has been in contact with the Department of Consumer Affairs, which confirms its availability for this function. (It administers the Dispute Resolution Programs Act.)

Small Claims Jurisdiction

In connection with the proposal to use the small claims procedure for enforcement of CID assessments, it should be noted that we do not have good empirical data concerning the size of assessment arrearages. If assessments exceed small claims jurisdictional limits, that could defeat the effort to localize assessment enforcement in the small claims division of the superior court.

Also, if judicial foreclosure is to be available as a remedy for enforcement of an assessment judgment, it may be desirable to provide greater procedural protections to the homeowner than are available under small claims procedure. Of course, an appeal by trial de novo in the superior court would ordinarily be available to the homeowner under small claims procedure.

Director Liability

Memorandum 2002-10 sets out a possible sanction on directors for bad faith actions in the dispute resolution process. In addition to other concerns about such a provision, the Commission should consider that it might require breech of the confidentiality normally applicable to dispute resolution procedures in order to implement such a sanction.

We should perhaps also be concerned that a monetary sanction against a board member might as a practical matter trigger retaliation and merely contribute to deterioration of the relationship. Should removal from the board be an alternative or supplemental sanction for bad faith action? That could take the matter beyond small claims jurisdiction, although arguably it could be done by means of a conditional judgment.

Other Procedures

Lester Thompson suggests another avenue for dispute resolution. Under his proposal, if a member challenges a board action, the association must obtain a legal opinion from its attorney on the matter. If the opinion does not settle the dispute, it is submitted to the Attorney General for a determination (the cost of the Attorney General's determination to be paid by the association). If the Attorney General's opinion is unacceptable to either party, judicial review would be available at the expense of the association. Exhibit p. 5.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

Exhibit

COMMUNICATIONS CONCERNING MEMORANDUM 2002-10

Lester H. Thompson, January 11, 2002 (#1)

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

Dear Members of the Commission:

While reading the memorandums and reports regarding the Commission's review of common interest developments (CIDs) often some are referred to as being dysfunctional. By the research to date you must conclude that no one really knows how many CIDs could be classified as dysfunctional. Stating that a few fall into this category is contradictory to the known research. It could very well be discovered that the far majority may be dysfunctional in one way or another.

With no agency of the State of California having the responsibility to oversee the CIDs it may well be considered that the CID concept itself without oversight is indeed dysfunctional. It is doubtful that the State actually knows how many CIDs exist that make up this "valuable housing stock". We know the State in fact did impair the existing declarations (the CC&Rs which are a contract) of CIDs by adopting Civil Code § 1366 (b) which overrides existing contracts by permitting a higher increase in assessments. We are aware that this action may be justified by the U. S. Supreme Court's three part test for determining if the interference with an existing private contract is constitutional. The test considers (1) the severity of the impact on the private contract; (2) the public purpose served by the legislation; and (3) the reasonableness of the legislation. Since at the time inflation prevented many associations from increasing their assessments sufficiently to perform its obligations, Civil Code § 1366 (a), and particularly funds for reserves this condition endangered the "valuable housing stock" and prompted the override. The Civil Code § 1365 requires reserve studies but there is no statute that requires one penny to be reserved for maintenance, repairs or replacement to prevent the deterioration and loss of this valuable housing stock. Many reserve analysts estimate that the far majority of CIDs are extremely underfunded and are in danger of losing this housing stock as only a very high special assessment could save the project and such a special assessment would not be affordable by the owners. A conservative estimate by most reserve analysts put well over 50% of the associations in this position. That is not a few being dysfunctional but in fact the majority being dysfunctional and I would suggest that this example may be far more destructive to the CIDs than the problems being presently discussed regarding improved decision making and ADR.

The State should require that the laws that are adopted to regulate CIDs are overseen and enforced without depending upon the owners to enforce the laws by Judicial oversight. This should especially be done if the legislators of California are at all truly concerned regarding the preservation of the CID housing stock and the protection of the health, safety and welfare of the citizen owners of CIDs whose private contracts they have seen to impair for those reasons.

I ask you to please keep in mind that the legislators themselves have no where to turn when trying to assist one of their constituents with a CID problem and must resort to recommending hiring an attorney. The Attorney General doesn't presently assist any owners as the associations know that the AG will wind up recommending that the owner hire an attorney stating that they have no funding to pursue the enforcement of laws they are responsible to oversee.

Some industry organizations fight to keep this unfair and unreasonable situation to exist while falsely proclaiming to represent the CID owners and their best interests. The attorneys practicing homeowner association (HOA) law in Orange County recently proclaimed that the practice of this law was " recession proof"! That statement alone should be enough to make everyone realize how unfair and unreasonable CID law actually is!

There are so many more reasons that some type of oversight is needed for CIDs but the list would be too extensive at this time and maybe too shameful to list them! One thing for certain is that the "oversight" provided by the industry organizations with their primary interest being a living from the CIDs and the so called "Judicial oversight" is not in the best interest of CID owners!

Please lets not limit our belief that any funding to provide a "door tax" for the establishment of oversight for the benefit of CID owners would be detrimental to any CIDs as all CIDs would benefit from such funding. When the need is crying out to the State and is so obvious oversight should not be limited to any one problem or phase of CID operations.

Sincerely,

Lester H. Thompson
612 Brookview Way
Costa Mesa, CA 92626-3131

Lester H. Thompson, January 11, 2002 (#2)

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

Dear Members of the Commission:

The following comments are respectfully submitted:

Civil Code § 1357.1 (b) (3) I would suggest the use of repetition rather than restatement or interpretation. Keeping the purpose of helping to reduce the number of disputes in mind numerous disputes are created between the association and the members when laws or governing documents which are uncertain or doubtful are restated or interpreted by the board. In the majority of instances this is done with the use of attorney opinions which in most cases are bias toward the Board's desire and which in many instances is not in the best interest of the association. The attorney opinions are not made available to members whose association is actually the client of the attorney and although no litigation is involved the reason cited is always that it is privileged communications. In some instances rules are created or resolutions are adopted that are not within the limits of the authority of the board and indeed may impair the declaration (contract) and amount to an amendment of the declaration without a vote of the members which is required by statute.

I would suggest the following procedures to reduce these disputes:

1. Any law that is uncertain, doubtful, needing clarification, or conflicting with other statutes should be submitted to a Court for interpretation prior to any action by the association. All costs should be an expense of the association. The doubtful or uncertain law should also be submitted to the legislature for a change or an explanation of the law.

2. Any provision of the governing documents that are doubtful, uncertain or needing clarification should be submitted to the association members with an opinion of the Association's attorney for their information and a proposed amendment to the governing documents to be voted on by the members to resolve the problem.

The major problem with the enforcement of the law or governing documents between the owners and the association is the fact that any attempt to do so would be between adversaries of substantially different financial strengths. The system is not fair or reasonable and the owners become apathetic and submit to accepting decisions of the association since they cannot in the majority of instances afford simple mediation costs let alone the cost of legal counsel. In many instances the dispute could involve a cost of $1,000.00, for example, but is not challenged by any member when the cost of any alternative dispute resolution would exceed that amount and not be worth the expense or effort.

ADR should be made more friendly to all parties. I would suggest the following:

1. All attorney opinions obtained by the board of directors shall be made available to members for review and a copy shall be supplied upon request at the Association's cost for the copy except for attorney opinions concerning litigation. Litigation is defined as meaning a lawsuit or legal action including all proceedings therein but hypothetical, anticipated or threatened litigation is not considered to be litigation. NOTE: This definition of "litigation" should be included in Civil Code § 1351 Definitions.

2. Oversight of ADR should be assigned to the Office of the Attorney General. This cost would be minimal considering the taxes paid by these owners and the fact that over 25% of the population of California now resides in common interest developments that deserve this service.

3. Mediators and Arbitrators should meet qualifications established and approved by the AG. The approved persons and their qualifications should be available to the public. This could easily be done by a web sight.

4. Both binding and nonbinding arbitration should be appealable to the Civil Court system. No one is infallible and mistakes or incorrect determinations should be correctable.

5. Affordable fees should be available for the procedures based on the many areas claiming to provide these affordable fees. These fees should be shared by the parties. Each County should have an AG approved mediation center. This information should be available on the web site.

6. Attorney fees for ADR should be paid by each party with no award for attorney fees to either party. This risk is a further deterrent to an owner to seek justice.

7. Associations should not be permitted to refuse ADR.

8. The selection of a mediator or arbitrator must be acceptable to both parties. If an agreement cannot be reached the Office of the Attorney General shall be asked to make an assignment.

9. Require a procedure where the board would appoint a member to meet and have confidential communication with the member regarding the dispute in an attempt to settle the dispute prior to ADR. In many instances the board refuses to have any communication with the member regarding the dispute at the advice of the association attorney. That stops any communication and forces legal proceedings which in many cases could possibly be avoided.

10. The Office of the AG should have a web site devoted to common interest developments with information available to CID owners. The site could have a list of frequently asked questions (FAQ) and answers which may help prevent disputes. ADR procedures should be listed with explanations and copies of needed forms. Court decisions applicable to CIDs with a simple explanation in layman

language regarding the decision may help resolve anticipated disputes that are similar. The site could link many web sites that may help the owner including the CA sites where the Davis-Sterling CID Act could be viewed.

11. When there is a written challenge submitted to the board for noncompliance of the law or the governing documents by the board the association shall obtain an opinion from the Association's attorney regarding the issue at the Association's expense. This opinion shall be available to the members for review and a copy shall be provided if requested by members at a cost not exceeding the cost to the association for the copy. If this opinion does not settle the issue or dispute it shall be submitted to the Office of the AG for a determination. The Office of the AG shall charge a reasonable fee for the determination not to exceed, as an example $1,000.00, which shall be paid by the association. If the determination by the Office of the AG is not acceptable to either party the association shall seek a determination by the Courts at the sole expense of the association.

Respectfully submitted:

Lester H. Thompson
612 Brookview Way
Costa Mesa, CA 92626-3131