Study H-851 September 9, 2003

# First Supplement to Memorandum 2003-31

## Alternative Dispute Resolution Under CID Law

The Commission has received four letters commenting on issues raised in Memorandum 2003-31. Those letters are attached in the Exhibit as follows:

*Exhibit p.*

1. John Jones, Aliso Viejo (Aug. 11, 2003) . . . . . 1
2. Bruce Osterberg, Escondido (Aug. 11, 2003) . . . . . 3
3. Peter Siggins, Chief Deputy Attorney General (Aug. 25, 2003) . . . . . 5
4. Commissioner Paula Reddish Zinnemann, Department of Real Estate (Sept. 5, 2003) . . . . . 6

The issues raised in the letters are discussed below.

### PRE-LITIGATION ADR

One issue raised in Memorandum 2003-31 is the question of whether existing pre-litigation ADR requirements should be revised to require actual participation in ADR (as opposed to a requirement that a plaintiff "endeavor" to submit a dispute to ADR). Mr. Jones agrees with other commentators that the ADR provision should remain voluntary. He notes the precedent-setting value of litigation and is concerned that mandatory ADR could undercut judicial development of the law. See Exhibit p. 2.

### ENFORCEMENT OF GOVERNING DOCUMENTS

Mr. Osterberg finds the staff recommendation regarding owner enforcement of an association's governing documents to be unclear. See Exhibit p. 3. To clarify: the staff feels that the proposed law should not provide for owner enforcement of governing documents (other than the declaration) against another owner. However, it might be useful to add language making clear that an owner can enforce the governing documents against the association itself.

**Preferred Approach**

On page 12, Memorandum 2003-31 sets out a range of alternative approaches to the question of fee shifting in a dispute between a homeowner and a homeowners association. Both Mr. Jones and Mr. Osterberg preferred the third alternative. See Exhibit pp. 2-3. That alternative would broaden the existing fee shifting provision so that it applies in a dispute involving the Davis-Stirling Common Interest Development Act or the Nonprofit Mutual Benefit Corporation Law. In addition, that alternative would provide for "preferential" fee shifting — a homeowner would be entitled to fees on "prevailing" but the association would only be entitled to fees if the homeowner's case is "clearly frivolous."

Mr. Jones writes, at Exhibit p.2 (citations omitted):

> It has grieved me to hear my neighbors express their feelings of powerlessness in the face of unresolved maintenance issues, unfair enforcement procedures and board failures to abide by the governing documents. This sense of helplessness reflects the need to address the "unequal strength" problem so that individual homeowners have the resources to right the wrongs they now feel powerless to address. … As your memo rightly states, "the consequences of board mismanagement in a CID are probably much more significant and personal than in the typical nonprofit corporation." …
>
> One area that I find particularly bothersome is the application of the Common Interest Development Open Meeting Act. When I was on the board I tried to open up the process but I was told by our manager that our attorney had said homeowners did not have a right to speak during the meeting and that by providing a homeowner forum at the beginning of the meeting we were in compliance with the law. That didn't feel right to me and my recent readings seem to confirm my initial distrust of that opinion. Homeowner involvement is critical to the health of an association and this is an area where homeowners need to be empowered. And yet what sensible person would be willing to press for their rights if they thought they were going to get slammed with attorney fees? Implementing the preferential fee shifting model will be a step in the right direction for redressing the imbalance of power that now exists.

**Separate Track of Study**

Because the issue of attorney fee shifting is likely to be complex and controversial, the staff recommended that the matter be pursued on a separate

track from the rest of the CID ADR proposals. That would allow the Commission to take the time necessary to address the issue carefully, without delaying the progress of the other proposals. Mr. Jones believes that approach is "sensible." See Exhibit p. 2. Mr. Osterberg cautions that delay might be seen as protection of association management interests. He believes the need for reform of the fee shifting provision is urgent. See Exhibit p. 3.

The staff agrees that fee shifting is an important issue. However, there are many technical issues that would need to be resolved in crafting any fee shifting provision.

## INTERNAL DISPUTE RESOLUTION

A number of points were made regarding the proposed internal dispute resolution process.

### Disputes Between Members

Mr. Jones agrees with other commentators that the proposed law should not require that the board offer a process for resolution of disputes between homeowners. See Exhibit p. 1.

### Written Request

Mr. Jones believes that a request to use the internal dispute resolution process should be in writing — "there is far too much room for misunderstanding in an oral request." See Exhibit p. 1.

### Board Representation

Mr. Jones writes, at Exhibit p. 1 (citations omitted):

> I am concerned about the proposed law making this process mandatory on the board. … Although I am in favor of the intent behind this provision there may be circumstances where compelling a board member into a one-on-one conference is inappropriate. If I were on a board I would feel very uncomfortable having to deal one-on-one with someone who is mentally unbalanced or out-of-control. I would also feel that I was putting my fellow board members at risk if they were chosen for such an onerous task. To top it off, if things go awry you have no witnesses.
>
> I think that greater flexibility should be allowed in who the board should delegate for the meet and confer process. The proposed law allows the board to "designate a member of the board to meet and confer." … Depending on the dispute it may be

> more efficacious to allow someone other than a board member to handle the matter and in some instances it may be desirable to have more than one board member.

Memorandum 2003-31 discusses alternative approaches to board delegation of authority to meet and confer. One option would be to provide for representation by committee. The board would set the committee at whatever size it chooses. Representation by more than one member of the board would defuse some of the personal discomfort that might arise in a one-on-one meeting.

Mr. Jones also suggests that the board should be able to appoint a representative who is not a board member. Such an approach would undoubtedly raise concerns amongst those who are leery of delegating board authority to resolve disputes. As originally drafted, the proposed law would allow the board's representative to enter into binding agreements on behalf of the association. ECHO expressed serious concerns about whether delegation of board authority to a single board member would be proper. Delegation of board decisionmaking authority to someone other than a member of the board stretches the concept of delegation even further.

One alternative discussed in Memorandum 2003-31 would be to require board ratification of any agreement reached in the meet and confer process. Under that approach, use of an agent to negotiate would not undercut the board's role as decisionmaker.

A proposed variation of the board ratification approach would be to apply a presumption of correctness to any agreement reached in the meet and confer process. The board would be required to ratify that agreement unless it determines that the agreement would conflict with law or the association's governing documents. Mr. Jones endorses that approach. See Exhibit p. 1. That degree of delegation seems consistent with existing Corporations Code Section 7210, which allows a board to delegate management functions so long as the delegated powers are "exercised under ultimate direction of the board."

**Cost of Procedure**

Memorandum 2003-23 proposes a revision to proposed Section 1363.830(e), to make clear that a participant in the dispute resolution process may not be charged a fee for participation. Mr. Jones agrees with that revision. See Exhibit p. 1.

**Optional Approach**

The proposed dispute resolution process requires that an association provide a procedure satisfying a few specific requirements. If the association does not provide such a procedure, the default meet and confer process applies. This gives an association an option, rather than imposing a single procedure to govern every association in the State. Mr. Jones supports the approach. He writes, at Exhibit pp. 1-2:

> I am in favor of this approach. One thing I have noticed as I've read through the various CID papers you've circulated is that while the guiding principles behind your ideas are sound, people have taken exception to particular items. By adopting this principle based approach you can forestall some of these criticisms. (On a related note, I've heard that the Securities and Exchange Commission is also considering a principle based approach to rule making. Apparently they've discovered that people were focusing on making sure they didn't break the rules instead of focusing on the principles that informed the rules.) On the other hand, some associations may appreciate having a model that provides specific guidance. The optional/default approach should satisfy both those who want flexibility and those who need specific guidance.

CID INFORMATION CENTER

At Exhibit p. 4, Mr. Osterberg writes in favor of creation of a State-run CID information center:

> Very often discussion stops anger from growing to dangerous levels. On the other hand explaining alternatives can help a homeowner resolve differences without legal action. As much as I oppose new taxes, I grudgingly support homeowners paying a part of the cost. The other part should be a fee imposed on the builder when a CID is permitted.

We also received letters from the Department of Justice and the Department of Real Estate indicating that they are unable to take on responsibility for the proposed CID information center at this time. The Department of Justice indicated that its existing telephone system is already overtaxed and that it could not afford to update that system and maintain CID information on its website without an additional appropriation. See Exhibit p. 5. The Department of Real Estate also cites cost concerns, indicating that any additional burden on its resources would be problematic. See Exhibit pp. 6-7.

If it turns out that none of the suggested agencies are willing to undertake responsibility for maintaining the information center, there is one other alternative that is perhaps worth considering — the Commission could do it as a pilot project. We have experience operating a simple website at very little cost. The only staffing burden would be the need to annually update the information provided to reflect amendments to statutes and regulations. The website could include an on-line survey for users to evaluate its usefulness. At the end of the pilot period, the Commission could prepare a report on the merits of the center, with a recommendation as to which agency should take it on permanently (if any). Agencies might be more willing to accept that responsibility once the concept has been tested and the actual operating costs determined.

If this approach is taken, the staff would recommend that the provision for an automated telephone answering system be deleted from the proposed law. The Commission is not currently equipped to provide such a service. We should also consider adding a modest fee to the CID registration process overseen by the Secretary of State, in order to provide a small source of revenue to fund the project.

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94353-4739

August 11, 2003

RE: Memorandum 2003-31, Study H-851 (ADR under CID Law)

Dear Sirs and Madams,

I understand that you will be discussing the issue of Alternative Dispute Resolution for Common Interest Developments at your hearing scheduled for September 19, 2003. I offer the following for your consideration:

INTERNAL DISPUTE RESOLUTION:

- I agree with the staff recommendation to limit internal dispute resolution to disputes between the association and a member. The comments of Ms. Franco, G. Perrin, and Mr. Dolnick on this subject are persuasive. (pp16 -20)

- I urge the Commission to honor staff's inclination to revise the proposed law to require a written request. Mr. Dolnick's comments here are right on target; there is far too much room for misunderstanding in an oral request. Writing a letter is not that much trouble and pro-active associations could provide a form for the purpose. (pp 24-25)

- I am concerned about the proposed law making this process mandatory on the board. (pg 15, 19, 20) Although I am in favor of the intent behind this provision there may be circumstances where compelling a board member into a one-on-one conference is inappropriate. If I were on a board I would feel very uncomfortable having to deal one-on-one with someone who is mentally unbalanced or out-of-control. I would also feel that I was putting my fellow board members at risk if they were chosen for such an onerous task. To top it off, if things go awry you have no witnesses.

- I think that greater flexibility should be allowed in who the board should delegate for the meet and confer process. The proposed law allows the board to "designate a member of the board to meet and confer." (pg 20) Depending on the dispute it may be more efficacious to allow someone other than a board member to handle the matter and in some instances it may be desirable to have more than one board member.

- I agree with the staff recommendation regarding board ratification of an agreement reached by the board's representative, with the board operating under a presumption that the decision is correct. (pg 22)

- I agree with the wording change recommended by staff on page 26 regarding the costs of internal dispute resolution.

- You have requested comment on the optional/default approach. (pg. 24) I am in favor of this approach . One thing that I've noticed as I've read through the various CID papers you've circulated is that while the guiding principles behind your ideas are sound, people

John Jones 191 Cinnamon Teal, Aliso Viejo CA, 92656 Phone: 949 586 3946

have taken exception to particular items. By adopting this principle based approach you can forestall some of these criticisms. (On a related note, I've heard that the Securities and Exchange Commission is also considering a principle based approach to rule making. Apparently they've discovered that people were focusing on making sure they didn't break the rules instead of focusing on the principles that informed the rules.) On the other hand, some associations may appreciate having a model that provides specific guidance. The optional/default approach should satisfy both those who want flexibility and those who need specific guidance.

VOLUNTARY VS. MANDATORY ADR

I agree with the approach of keeping ADR voluntary. (pg. 14-15) How CID related conflicts are resolved have far-reaching social consequences and for this reason some people may want a matter litigated to create a public record. If all CID conflicts are forced into ADR there may be a vacuum created by the absence of judicial opinion.

ATTORNEY FEE SHIFTING

I think the staff's proposed alternative to pursue the fee shifting issue on a separate track (pg 12) is sensible, given ECHO's request for a "full briefing on the subject." (pg 7)

However, in principle I favor Option #3, which would broaden the fee shifting provision and make it preferential. (pg 12) It has grieved me to hear my neighbors express their feelings of powerlessness in the face of unresolved maintenance issues, unfair enforcement procedures and board failures to abide by the governing documents. This sense of helplessness reflects the need to address the "unequal strength" problem so that individual homeowners have the resources to right the wrongs they now feel powerless to address. (pg 7) As your memo rightly states, "the consequences of board mismanagement in a CID are probably much more significant and personal than in the typical nonprofit corporation." (pg. 11)

One area that I find particularly bothersome is the application of the Common Interest Development Open Meeting Act. When I was on the board I tried to open up the process but I was told by our manager that our attorney had said homeowners did not have a right to speak during the meeting and that by providing a homeowner forum at the beginning of the meeting we were in compliance with the law. That didn't feel right to me and my recent readings seem to confirm my initial distrust of that opinion. Homeowner involvement is critical to the health of an association and this is an area where homeowners need to be empowered. And yet what sensible person would be willing to press for their rights if they thought they were going to get slammed with attorney fees? Implementing the preferential fee shifting model will be a step in the right direction for redressing the imbalance of power that now exists.

Sincerely,

John Jones

John Jones 191 Cinnamon Teal, Aliso Viejo CA, 92656 Phone: 949 586 3946

Bruce Osterberg
1809 Wintergreen Glen
Escondido, CA 92026-4938

760.741-1940
Fax: 741-8765
mw1809wg@nctimes.net



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Nathaniel Sterling, Executive Secretary
California Law Revision Commission
4000 Middlefield, Room D-1
Sacramento, CA 94353-4739

650.494-1335 x16
sterling@clrc.ca.gov

Comments on
California Law Review Commission
Memorandum 2003-31
CLRC MM03-31

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Nathaniel Sterling,

On page 6, Enforcement of Governing Documents, your staff recommends owner enforcement of the governing documents be deleted. The next sentence of your staff's "inclination" is unclear. Currently, code is regularly ignored by boards and management companies - so adding more code is not an answer.
The situation now is that if a homeowner violates code or governing documents the board can lien property, at little or no risk. That is very forceful, kind of like hitting the homeowner with a club until obedient. On the other hand, if the board and/or the management company is violating code or governing documents the homeowner must put up 'at-risk' funds, then use a great deal of personal effort to be successful, and even if successful, compliance is usually not satisfactory. Not acceptable!

On page 12, Fee Shifting Alternatives, your staff recommends "no action for now". That might be technically correct but it is not wise. The time for action is now. There is very strong animosity regarding the current reckless abuse of power by board members and management companies. Your suggestion of no action appears as if you are protecting the lawyers and the management companies. I support alternative #3.

## MM03-31 Comments

On page 33, Resolution Information Center, your staff recommends that one be established. I agree. Very often, discussion stops anger from growing to dangerous levels. On the other hand explaining alternatives can help a homeowner resolve differences without legal action. As much as I oppose new taxes, I grudgingly support homeowners paying a part of the cost. The other part should be a fee imposed on the builder when a CID is permitted.

Crucial to the success of an Information Center are the guidelines of what subjects - and to what depth - might be addressed.

Remember, the public is savage when it finally does react to what it perceives as incorrect behavior by government. Recent examples are Prop 13 and term limits. By any definition a CID board is government. The main weakness in the current CID structure is the lack of oversight. All other forms of government have oversight - the press. As the number of CIDs grow, so will resentment. Action must be taken to stop the current abuse of individual homeowners or the entire CID structure will be damaged or destroyed.

I hope these comments are worth noting. However, I am more comfortable creating solutions rather than criticizing others' efforts.

Bruce Osterberg

Bruce Osterberg

cc: Pat Bates, 73rd District Assembly Member

STATE OF CALIFORNIA
OFFICE OF THE ATTORNEY GENERAL
BILL LOCKYER
ATTORNEY GENERAL

PETER SIGGINS
Chief Deputy Attorney General
Legal Affairs

August 25, 2003

Mr. Brian Hebert
Assistant Executive Secretary
California Law Revision Commission
3200 5th Avenue
Sacramento, CA 95817

Re: Common Interest Development Information Center

Dear Mr. Hebert:

Thank you for the opportunity expressed in your July 28, 2003, letter to comment on the Law Revision Commission's proposal to establish a Common Interest Development Information Center.

Common interest developments are important to large groups of Californians, many of whom are unfamiliar with their rights, responsibilities and remedies. Although the Office of the Attorney General does have automated telephone lines, we are operating beyond capacity, a problem we expect will become increasingly serious over the next several years. The establishment and updating of the additional web-site materials would also be labor intensive in a time of fiscal belt-tightening. We therefore regret that we cannot at this time take on this added responsibility without budgetary assistance.

Sincerely,

PETER SIGGINS
Chief Deputy Attorney General
Legal Affairs

STATE OF CALIFORNIA — BUSINESS, TRANSPORTATION AND HOUSING AGENCY GRAY DAVIS, *Governor*

**DEPARTMENT OF REAL ESTATE**
OFFICE OF THE COMMISSIONER
2201 Broadway
P.O. Box 187000
Sacramento, CA 95818
(916) 227-0782



September 5, 2003

Brian Hebert
Assistant Executive Secretary
California Law Revision Commission
3200 5th Avenue
Sacramento, CA 95817

RE: Common Interest Development Information Center

Dear Mr. Hebert:

This letter is in response to your July 28, 2003, correspondence in which you advise that the California Law Revision Commission is considering the creation of a State-run Common Interest Development Information Center, and that the Department of Real Estate is one of the agencies under consideration to host the Center.

Your letter indicates that the basic premise for a proposed Common Interest Development Center is for a State agency to be available to provide general information about living in a common interest development and the rules that regulate them. The information would be housed on the agency's website and also provided through an automated telephone answering system, which would serve solely as an alternative means of providing the information that is on the website. The information to be disseminated would include information on common interest development law, dispute resolution and any other information deemed useful to those living in a common interest development.

While the Commission's proposal is laudable, it would not be appropriate for the Department of Real Estate to host such an information center at this time. Although your letter states "the cost of monitoring the information center should be relatively minor," given the current budget situation, any additional burden on the Department's remaining fiscal and personnel resources would be problematic.

Currently, the Department must focus on its core responsibilities as it appears available resources may continue to decline. In addition, I am not sure I agree with the assessment that hosting an information center as you describe would be minor. As you know, it is estimated that there are over 35,000 common interest developments in California that are housing millions of residents, and those numbers continue to grow. Although it is the Commission's

desire not to have the agency hosting the information center provide advice or counsel to homeowners, it is inevitable that those seeking information which is not found on the website or which is not to the consumer's satisfaction will contact the host agency. As it now stands, the Department of Real Estate receives over a million calls a year related to areas within its jurisdiction. This fully taxes our current system and resources. It would not be prudent to burden the system further with issues beyond the Department's core functions and responsibilities. Also, as to cost, having experienced the design and maintenance of a website and an interactive voice response system, the projection that it will be minor may be optimistic.

I want to thank you for considering the Department of Real Estate, however, without sufficient resources, it would be imprudent for the Department to accept responsibilities outside its core functions.

Sincerely,

PAULA REDDISH ZINNEMANN
Real Estate Commissioner

PRZ:lrs