Study H-853 September 16, 2004

Second Supplement to Memorandum 2004-39

State Assistance to Common Interest Developments (Staff Draft)

We received an email from Lisa Martin commenting on Memorandum 2004-39 and its First Supplement. That email and replies exchanged between Ms. Martin and the staff are attached in the Exhibit. We also received an email from Lewis Wong, which is attached in the Exhibit. Finally, we received a letter from Donie Vanitzian. As that letter is mostly concerned with the Commission's proposal on unincorporated association governance, it is attached to the Second Supplement to Memorandum 2004-41. Comments in the letter that are relevant to the common interest development proposal are discussed in this supplement.

MS. MARTIN'S COMMENTS

Ms. Martin is a CID homeowner and association board member. She is generally supportive of the proposed law but has two general suggestions:

(1) There should be a strong emphasis on education and other assistance to association boards. The staff agrees.

(2) A bar on indemnification of a board member sanctioned by the bureau may deter board service. The Commission should consider that possibility.

MR. WONG'S COMMENTS

Mr. Wong is enthusiastic about some form of state assistance to associations. He makes three general suggestions:

(1) The bureau would provide benefit to homeowners who are knowledgeable about their rights. The cost of the bureau will be borne by all homeowners, including those who are not aware of the bureau's existence. As a result, less sophisticated homeowners will subsidize services to more sophisticated homeowners. Mr. Wong suggests that the bureau be funded on a fee-for-service basis.

(2) ADR should be mandatory and formalized, serving in part to develop the facts for any subsequent litigation.

(3) The Department of Corporations should also have jurisdiction to mediate disputes, especially those involving violation of corporate governance laws.

MS. VANITZIAN'S COMMENTS

Ms. Vanitzian believes that common interest development law is fundamentally flawed and predicts that any effort to provide state assistance to common interest development homeowners would fail catastrophically. Nonetheless, she offers two suggestions regarding the proposed law:

(1) Association directors and officers should not be indemnified under any circumstances. Indemnification encourages misconduct.

(2) Any state oversight of common interest developments should be within the Department of Corporations. Note that this suggestion is based in part on Ms. Vanitzian's mistaken belief that the Commission is proposing that all homeowners associations be required to incorporate.

DEPARTMENT OF CORPORATIONS JURISDICTION

The Department of Corporations has jurisdiction to regulate certain professions involved in financial transactions. It does not enforce laws relating to the governance of corporations. The Department's website recommends that a person who has a dispute about the governance of a corporation should seek private counsel or contact the Attorney General. See the Department's website at www.corp.ca.gov/enf/enffaq.htm.

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary

Exhibit

EMAIL SUBMISSION FROM LISA MARTIN (9/14/04)

From: Lisa Martin
To: bhebert@clrc.ca.gov
Subject: Common Interest Developments
Date: 14 Sep 2004

I would like to applaud the Commission's study of Common Interest Development Law and the proposed creation of a Common Interest Development Bureau in the Department of Consumer Affairs.

After living in my Common Interest Development for 20 years, I finally joined the Board of Directors as of 1/2003. Since then I have done my best to become an educated Board member.

As I read and watch and learn, I am increasingly aware of an overriding theme of evil Boards doing terrible things to innocent homeowners.

What I do NOT see, is much information about the difficulty of getting homeowners to join the Board of Directors. When I joined the Board, we had a full complement (9) for the first time in many years for our 257 home association. Most of the Board is serving "illegally" in that they have surpassed their allowed terms of office. This is excused because we can find no replacements. I understand that this is a common problem with HOAs.

Within our Board of Directors, I have found lack of education, lack of interest, lack of energy, lack of multi-cultural understanding, lack of documentation and many other lacks. I have not found malice.

I am suggesting that the first recommended remedies for any dissatisfied homeowner is that he/she:

- Read his/her Association documents
- Join the Board and/or committees of his/her HOA

I am also requesting resources for Boards of Directors.

- Assistance is desperately needed for understanding CID law and guidance in amending governing documents.
- Assistance is desperately needed to rally homeowners and get them to vote, provide quorums and join Boards and committees.

- Property Management companies are biased towards their own interests. They prefer "stable" boards they can manipulate. They can assert too much influence over passive Boards.
- Monetary and staffing requirements for the proposed Common Interest Development Bureau could be dramatically reduced if HOA Boards have an unbiased resource. Many disputes could simply be averted.

I am deeply concerned about provisions to restrict indemnification.

- Due to our Board's reliance on oral history and memory (which, of course, differs between each Board member) rather than documentation, I would be loath to put myself at risk.
- I suspect our Board is the norm rather than the exception.
- It is already extremely difficult to get HOA members to join the Board. Losing absolute indemnification would further restrict the pool of candidates and exacerbate the problem.

Sincerely,

Elisabeth C. Martin
Regency Park Townhouse Association
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EMAILED STAFF RESPONSE TO LISA MARTIN (9/14/04)

To: Lisa Martin
From: Brian Hebert <bhebert@clrc.ca.gov>
Subject: Re: Common Interest Developments
Date: 14 Sep 2004

Ms. Martin,

Thank you for commenting on the proposal.

Regarding the proposed prohibition on indemnification, the Commission is aware of the difficulty many associations have in finding volunteers who are willing to serve. We realize that any sort of penalty imposed on directors or

officers may tend to deter service. However, the potential deterrent effect should be minimized if penalties are reserved for misconduct that clearly crosses the line from negligence or accident into the realm of intentional harm or conscious disregard for the rights of others.

In the proposed law, a director or officer could only be personally sanctioned if the bureau finds, "by clear and convincing evidence" (a higher than ordinary standard of proof), that a violation involved "malice, oppression, or fraud", as those terms are defined below:

> (1) "Malice" means conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others.
>
> (2) "Oppression" means despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights.
>
> (3) "Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.

In principle, a person acting in good faith need not worry about liability under that standard. In reality, you might be correct about the potential deterrent effect and the Commission will need to take that into account in deciding whether to include the indemnification language in the proposed law.

It is worth noting that existing corporations law only permits indemnification if a director or officer has acted in good faith (there is no "absolute" right of indemnification). An act that involves malice, oppression, or fraud would not be an act of good faith. Therefore, the prohibition on indemnification is really just a specific restatement of existing law. Whether it would be perceived that way by potential volunteers is open to question.

Thank you for your assistance. I will provide a copy of your email to the Commission for its consideration.

Sincerely,

Brian Hebert
Assistant Executive Secretary
California Law Revision Commission

EMAILED RESPONSE TO STAFF (9/14/04)

From: Lisa Martin
To: "Brian Hebert" <bhebert@clrc.ca.gov>
Subject: Re: Common Interest Developments
Date: 14 Sep 2004

Thank you for your comprehensive reply.

I do understand the intent behind the personal sanctions. My concern is in the defense should the need arise.

Due to many liability and other legal concerns, our community manager recommends against maintaining detailed documentation. Again, I assume this is the norm for HOAs and would probably put proof of intent in the realm of "oral history"- which is a notoriously faulty mechanism and itself subject to malice. While I appreciate the "...clear and convincing evidence" standard, many people would be unable to grasp the subtleties inherent in this protection.

There are no education requirements for serving on a HOA Board. Legislation. Programs for HOAs and their Boards really need to be targeted at the lowest common denominator. Assume a scanty high school education and an inability to read. Add to that language and cultural differences. Throw in a "sound bite" mentality.

There are also few possibilities for personal gain other than maintaining/enhancing property values- a community-wide benefit. If there are even any "personal satisfaction" rewards, I sure haven't found them!

Assuming again that most Boards are like ours, we work hard to protect the homeowners. We forgive and overlook and try to protect. We are flailing around out here without any real guidance.

- We play Solomon and yet worry that we could be sued for discrimination.
- We try hard to contain costs and yet worry that we could be sued for inadequate maintenance.
- We come up with payment plans for homeowners we know are in final difficulty but try to balance that with fairness to the other owners.

Please don't let the vocal, litigious few rule and leave a seething majority. A positive approach to assisting these mini-governments would surely benefit the majority.

EMAIL SUBMISSION FROM LEWIS WONG (9/15/04)

From: Lewis Wong
To: bhebert@clrc.ca.gov
Subject: Re: Common Interest Developments Message
Date: Wed, 15 Sep

To Cal Law Review Commission,

Mr. Hebert,

I like to submit the following comment about the draft legislation on CID Oversight Bureau, of which some should be emphasized, some should be avoided, and some are added by me as new suggestion:

Emphasize :

---- Create " independent" Bureau, not appointed board or omission, for its key program, namely, ADR program is a judicial function.

---- ADR should be "mandatory" . The refusing party to ADR is always the board, for the HOA board rarely agrees to homeowner's request for ADR albeit that refusal can result in payment of attorney fees and cost for the directors can escape personal responsibility for such payments

----County Consumer Affairs Department is the least likely department to be politicized and has the most connection with the Cal AG or DA. Many cases can be handled criminally with restitution demand. This department is used to this kind of law enforcement.

----Cal department of Corporation must have "alternate jurisdiction" in accepting ADR cases for this department know much more about corporate govenance than any. All condo associations are subject to the Mutual Benefit Corporation's portion of the California Corporations Code. Most disputes in condo involve financial frauds by the management board. Let the Consumer affairs department kick the case to the Corporations department whenever the dispute is over Bylaws financial reporting and fiscal provisions' violation.

Avoidance

----36,000 Condo associations in California, or 3 million unit owners, or 1/4 of the population are not of equal economic background nor have equal awareness of legal rights. The result is that most of the condo owners will be paying for the legal cost incurred by a smaller portion of the condo owners that are located in well-off neighborhoods, If each unit is assessed $5 or $10 a year.

Instead, the pay-as-incurred by the participating parties in dispute, with less than market price of the service can be acceptable by Democrats and Republican

legislators alike for this will not create new tax obligation. Otherwise, the per unit assessment for legal cost will become unmanageable in ive years time, similar to managed health care costs.

Added Suggestion

----Participants (Mandatory participation) of ADR must use Cal. Judicial Form in filing complaints and answers according to the nature of their case.

There are many reasons for this:

a) For ease of future statistical survey of types of cases handled [One day the Bureau will want to find out what kind of cases that come before the CID Bureau, construction defects of individual units, assessment and foreclosure disputes, books and records inspection rights, premises liability, directors' breach of bylaws causing damages, etc. Such survey result can be had with almost no cost for improving the staff strength on the "most wanted" categories of ADR subject matter that require staff expansion.]

b) For statistical survey whether the unsuccessful ADR eventually reach the trial court.[That is to avoid having to restate the case in proper judicial format and manner of presentation if ADR fails. Lawyers will have to be forced to accept existing case files and not to large fees for writing the case from the ground up. The suspected wrongful party becomes more leery when it smell gun powder in the ADR stage, and try not to rely on hiring expensive lawyer to rewrite the case presentation and skip out some parts that need to be covered. The judicial form can easily spot out weak points on a case without looking the whole document over to detect salient points of dispute.]

c) For consistent legal handling or treatment of cases whether ADR or litigation. [The wrongful party has more room for protective cover with private lawyers lf the ADR is too informal, The wrongful party should come to grip that the proceeding is not very far remove from the court environment during ADR. Better take it serious. Omission of stating the defense's case properly will be having repercussion, for the file will go to the judge. The judge will read the case description if presented in judicial form for such forms are written by the judge's council of the court. The judge will read cases presented by their own council's form , namely, California Judicial Council form].

d) For uniformity in case presentation format {As stated before, the complaint and answer format in presenting argument of both sides are better to be uniform in all cases submitted for ADR. Using one type of form can guarantee uniformity. Do not let administrative officials design their own forms for the ADR.]

e) For uniformity of vantage point in treating the cases by the two branches of government personnel, administrative and judicial branches {Same reasoning as in above d, There should be no professional gap between the Bureau and the ordinary court in case file compilation.]

f) For developing expertise of paralegal through a consistent manner of registering reporting complaints and answers [If there is no uniformly prescribed form, the lawyers will monopolize any cases that are worth $5,000 or more for paralegal are not allowed to practice law and pleadings of any case of substantial value will have to be presented through attorneys that help them. Having judicial forms will escape that constraint

Add Department of Corporation as co-ADR mediation unit [Reason is as stated above].

I have been at this kind of thing since 1989 and am continuing to be at this kind of matter. Thus let me assert my above opinion. The Bureau is my life time hope. I never belief we come to this day for this legislative proposal. This is the second big thing since the fall of USSR. Millions would not have dreamed that they will be off the Soviet yoke in their life time. I thank you for letting us live.

Sincerely,

Lewis