Study H-853 September 28, 2004

Third Supplement to Memorandum 2004-39

State Assistance to Common Interest Developments

At the September meeting, Patrick McLane provided the Commission with a copy of a letter he sent to Assembly Member Patricia Bates on April 26, 2004. His letter, which offers constructive criticism of AB 2376 (enacted as 2004 Cal. Stat. ch. 346), is attached.

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary

April 26, 2004

The Honorable Patricia Bates
Room 4116, State Capitol
ATTN.: David Duran
Via e-mail: David.Duran@asm.ca.gov

Re: **AB 2376: Architectural Review: SUPPORT IF AMENDED (Revised)**

Dear Ms. Bates:

The following comments, observations, and recommendations are based on a review of **(1)** pending Bill No. AB 2376 (an act to amend Section 1373 of, and to add Section 1378 to, the Civil Code, relating to common interest developments) and **(2)** the "OPPOSE UNLESS AMENDED" letter (dated March 19, 2004) from Marjorie Murray (Chief Legislative Advocate/CID Housing, Congress of California Seniors) to The Honorable Patricia Bates (introducer of the said bill), and on the author's personal experiences and observations on the workings and tendencies of architectural review committees, homeowners' associations, and boards of directors in common interest developments. These comments, observations, and recommendations are intended to reinforce and supplement the observations and recommendations made in Ms. Murray's said letter.

The main overall problem with AB 2376 is that its provisions are so general and unspecific, and so lacking in enforceability, that its effectiveness is entirely dependent on the goodwill, intelligence, judgment, and objective fairmindedness of the architectural review committee members and boards of directors who would have the responsibility and power to carry out and enforce its very general and unspecific provisions. Unfortunately, it is the widespread and often abject absence of the requisite goodwill, intelligence, judgment, and objective fairmindedness that gives rise to the need for remedial legislation. Because of this unfortunate but dominant circumstance, it is now necessary to legislate **(1)** mandatory architectural review procedures, **(2)** a legally valid and effective process for the determination of legal issues and the review of adverse ARC decisions, and **(3)** the creation of a new agency with adjudication and sanctioning powers to provide governmental oversight and to handle homeowner complaints and appeals. The failure to provide effectively for each of these requirements will leave open the door for avoidance and abuse, resulting in legally and morally incorrect, improper, and unfair outcomes. The problem will remain unsolved, and common interest development homeowners will continue to be deprived of their legal property rights. On the other hand, the passing of effective legislation to meet the noted requirements should tend to encourage honest and meaningful compliance throughout the process.

The most fundamental and inherent problem with the current architectural review process is that it basically requires the determining of the legal property rights of applicant homeowners under the governing documents and related applicable law and legal principles, but assigns the power and responsibility for

considering and deciding legal issues (whether difficult or not) to lay people who are not trained in the law, who in many cases have no understanding of or appreciation for the concepts or the reality of due process and legal property rights, who are not mandated to follow due process procedures, and who refuse to recognize and/or acknowledge that legal issues are involved, insisting instead on applying their own subjective and legally irrelevant notions of what they perceive or claim to be "in the best interests of the community and the Homeowners' Association."

Architectural Review Committees (ARCs) and HOA Boards of Directors need to understand that in ascertaining the meaning and determining the proper application of laws, rules, and regulations restricting the use of real property they are required to recognize the common law principle that a homeowner's use of such homeowner's land is essentially unrestricted except as limited by other common law principles or applicable law, rules, or regulations. In this connection, if (1) there are no common law principles restricting the proposed building, structure, or use, (2) the building or other structure or use complies with all applicable governmental laws, including zoning and building codes (especially if confirmed by preliminary approvals of both the *Building and Planning Divisions* of the *Community Development Department* [or equivalent] of the applicable city or county jurisdiction), and (3) there are no legally applicable restrictions in the governing documents, the homeowner applicant is entitled as a matter of law to have the requested building, structure, or use approved, and neither the ARC nor the Board of Directors have any right or power to claim or assert discretion to deny the application.

A corollary principle of law is that prohibitions restricting otherwise legal uses (especially in a case where the proposed building, structure, or use has already been determined to be in compliance with all applicable zoning and building codes) must be sufficiently specific and unambiguous in establishing the intent to prohibit or regulate whatever it is that such prohibitions are claimed to apply to, or they are of no effect in accomplishing the asserted prohibition or restriction. In effect, laws, rules, and regulations proscribing or limiting otherwise legal buildings, structures, and uses are generally construed against the drafter or enforcing body, and are ineffective unless their meaning and intent are clear and unambiguous. For a guideline, prohibition, or restriction to be legally invoked to deny an application, it must be sufficiently clear for a reasonable person to reasonably conclude that such guideline, prohibition, or restriction might reasonably be applied as the legal basis for denying the proposed building, structure, or use. If no provisions in the governing documents are clearly applicable to the proposed building, structure, or use, there is no proper legal basis for disallowing such proposed building, structure, or use, and there is no discretionary right or power to deny the application. In the application of this principle, uncertainties are required to be resolved in favor of the homeowner subject to the restrictions. These principles tend not to be known, acknowledged, understood, and/or followed by ARC members and directors who prefer to think that they have

near absolute discretion to decide cases on their perceived, self-righteous view of "the best interests of the community and the homeowners' association," in total disregard, denial, and rejection of the applicable legal principles.

Developers may (and do) deliberately aggravate the problem by taking the position that problems relating to the functioning (or malfunctioning) of ARCs apply only to the homeowners' associations under whose auspices architectural review committees function, but not to developers. This is a bogus repudiation of the developer's responsibilities. Developers sell homes and homesites to residents subject to governing documents which the developers created (and which owners rely upon in making purchases and rightfully expect to be correctly enforced) and which they ultimately enforce through boards of directors which they tend to control in the early years of any development. It is recognized that architectural review committees tend to serve as a basic instrument for applying the governing documents for the benefit of the developer even where such committees are nominally creatures of a homeowners' association.

Also, it is arguable that because the primary responsibility for the de facto adjudication of legal property rights of homeowners has, in effect, been assigned by the State of California to "private governments," the absence of due process requirements in the governing documents of common interest developments, and the resulting lack of due process, constitute actionable violations of the due process protections guaranteed by the Constitution of the State of California. In any event, the delegation of government-like powers and duties to homeowners' associations creates an indisputable need for due process protections.

Following is an example of the merciless runaround and gross injustice that can occur under the existing system with no due process requirements and arrogant homeowner's association and board of directors' leadership. In this real case, no one on the ARC or representing the developer was able or willing to recognize or evaluate the homeowner's property rights under the governing documents in a legally correct or competent manner.

1. A homeowner's application for approval of a fully permissible accessory structure was denied by the ARC, claiming that the application had been "reviewed by legal" and was in violation of a certain section of the CC&Rs. The homeowner's arguments correctly explaining the inapplicability of the cited CC&R section were brushed aside. The reason for denial was notated on the application as "structure is in violation of CC&Rs." The ARC member (the developer's representative on the ARC) who made the notation refused to specify which CC&R section was being referred to because he "had not gone through the entire CC&Rs and was sure there were lots of sections scattered throughout" that were violated by the proposed structure.

2. The homeowner managed to get a member of the developer's sales organization to make inquiry on the homeowner's behalf in an effort to determine what was really behind the adamant rejection by the ARC. The homeowner provided the sales person with a copy of the developer's general plan which specifically and unequivocally permits the proposed structure. The sales person called the next day to say that the application would be reconsidered and to advise the homeowner to go to the next ARC meeting. When the homeowner called the ARC secretary, the reconsideration was not on the agenda and the secretary knew nothing about the matter being placed on the agenda for any forthcoming ARC meeting.

3. The homeowner prepared a letter to the legal assistant who had allegedly reviewed the case and identified the purportedly applicable CC&R section, **(a)** asking for a written explanation of the reasoning behind denying the application based on the particular section of the CC&Rs that the homeowner had been told the legal assistant had identified as the legal justification for the ARC denial, **(b)** presenting the homeowner's legal arguments explaining in a clear, comprehensive, and compelling manner why the cited section was totally inapplicable and why the structure was in fact legally permitted, and **(c)** asking for a written response to the homeowner's legal arguments and questions concerning the alleged application of the cited section.

4. After two weeks with no response, the homeowner called the legal assistant who said that she was not an attorney and could not give an opinion, that she had merely "flipped through" the CC&Rs following an informal request from the developer's ARC representative, and that she had been instructed by the developer's top manager not to give the homeowner anything in writing because the issue was "an association matter" and it would be "inappropriate" for the developer's legal staff to respond. But wait! Wasn't the "legal review" by this very person the basis of the ARC's denial? And why would it be "inappropriate" for the developer to be involved when **(a)** the developer had sold the homeowner the lot upon which the accessory structure was to be built by the homeowner after the developer completed construction of the main dwelling (and conveyed ownership of the property to the owner) with full knowledge and approval of the homeowner's intentions to build the accessory structure, **(b)** the developer had fully cooperated in having the main house built to accommodate the many service connections that would be needed for the secondary building and had actually contracted with and charged the homeowner for the extra work and materials, and also had made accommodations in the irrigation and drainage systems in anticipation of the building of the intended structure on the homeowner's lot after the homeowner took possession of the property, **(c)** the developer's top manager was President of the board of directors, and **(d)** the developer's controlled employees held a majority of the seats on the board of directors, and the board of directors would have the final say on any appeal from the ARC denial?

5. The Association's executive director called the homeowner to reiterate the reasons that the developer's legal assistant could not provide the homeowner with any legal

opinion. The director refused to forward the homeowner's letter and questions to someone who could give an opinion and answer the homeowner's objections, namely, the Association's attorney (who is also apparently the developer's attorney), saying that any decision to request a legal opinion could only be made by the Board. However, according to the executive director, the homeowner would have to appeal the ARC denial to the board of directors before the board of directors would even consider requesting a legal opinion. Thus, the homeowner would have to appeal without the benefit of knowing the response to such homeowner's legal arguments and without the opportunity to respond to whatever "legal opinion" the board might obtain from its accommodating counsel to "justify" the ARC's insupportable denial.

The foregoing example is the successor to a far more outrageous prior case involving the same property, wherein the ARC initially, and the board of directors upon review, absolutely refused to respond to presumptively conclusive and irrefutable legal arguments supporting the applicant homeowner's application for approval of a planned cottage, offering only the claim of having an 8-line "legal opinion" that did not acknowledge awareness of any of the applicant's extensive legal arguments, made no attempt whatsoever to respond to such legal arguments, and simply pronounced the conclusion concerning the alleged applicability of a certain section of the CC&Rs, with no explanation whatsoever. The same section of the CC&Rs provided the rationalization given for the rejection of the application discussed in the above-described case, again refusing to respond to the presumptively conclusive and irrefutable legal explanations and arguments made in the letter referred to in paragraph 3 above.

It is believed that the blatantly shameless manipulation, mendacity, unfairness, and disdain for legal correctness that have characterized both the recounted case and the earlier case alluded to in the preceding paragraph speak loudly to demonstrate the kind of abuses that can and do abound under the present system in the absence of any effective due process requirements, restrictions, appeals to independent and competent legal bodies, or sanctions. Simply by applying their awesome abilities and proclivities for manipulation, issue avoidance, stonewalling, delay, and obfuscation, ARCs, homeowners' associations, and developers, when so inclined, can conspire to create a situation wherein the homeowner attempting to exercise his or her legal property rights must come to realize, fatalistically and tragically, that "you simply can't get there from here." Unfortunately, it is believed that AB 2376, as presently drafted, is neither strong enough nor sufficiently specific and comprehensive to have any chance of bringing about the substantial reforms that will be necessary to create a system that will stand up to and, ideally, substantially eliminate the multitude of abuses noted in the cases commented upon in the preceding discussion.

For the foregoing reasons, including the needs so starkly demonstrated in the foregoing discussion, the three requirements enumerated in the second paragraph of this commentary are all necessary to assure procedural and substantive due process and the

resulting fair, honest, and legally correct resolution of issues affecting the property rights of homeowners in California's 36,000-plus common interest developments.

1. Mandatory architectural review procedures. Due process does not just happen, especially amongst lay persons with their own agendas and little or no understanding of or interest in fair procedures or the sanctity of legal property rights. Homeowners' associations' governing documents typically contain no meaningful provisions establishing procedures that assure due process to homeowner applicants for ARC approvals. Especially needed to assure the fair, honest, and legally correct resolution of issues affecting the property rights of homeowners, and to mitigate the serious abuses that can occur (and have occurred) under the present system, policies and procedures need to be developed to require that whenever a legal issue is raised where the homeowner and the ARC do not agree, each side must present its legal arguments and authorities in writing. All ARC requests for legal opinions should be required to be made in writing, furnishing the homeowner with a copy of the ARC's written request for its attorney's opinion, in order to assure that the issues have been fairly and accurately presented to the attorney. This should prevent the abuse of obtaining a desired answer/opinion from a cooperating attorney by misstating the problem, the issues, or the facts, or by failing to provide the ARC's attorney with actual copies of the legal arguments and explanations provided by the homeowner and requiring specific and detailed response and refutation by the ARC's attorney. In essence, there needs to be full disclosure of the ARC's legal opinions and of how they are obtained, and the homeowner must be given full opportunity to reply to the ARC's legal opinions.

A single page document entitled PROPOSED ADDITION TO AB 2376 (SEC. 2, ADDING SECTION 1378 TO THE CIVIL CODE) TO SPECIFY PROCEDURES FOR HANDLING LEGAL ISSUES REQUIRING CONSIDERATION IN THE DECISION-MAKING PROCESS is attached hereto for the purposes stated in its title. Its specificity is believed to be necessary because of the sad fact that the ARCs and boards of directors to which it will apply have demonstrated the kind of determination to avoid responsible and honest dealing with legal issues that has been so emphatically demonstrated in both of the cases referred to hereinabove.

No opinion is offered at this time as to what other procedures should or might be mandated, or as to whether such procedures should be left to the homeowners' associations to create and adopt or be legislated specifically and imposed as rules of procedure or as a model procedural code that can be adopted to achieve safe harbor compliance with a statutory requirement.

2. Determination of legal issues and review of adverse ARC decisions. If the ARC and the homeowner cannot agree on the proper resolution of legal issues or of any other important threshold issues after such issues have been fully vetted in the ARC setting, there needs to be provision for dispute resolution with the help of some legally

competent, independent, and mutually agreed upon third party (or parties). An example of a procedure for resolving disputes would be some practical, user-friendly mediation/-arbitration model, perhaps with reference to some existing provisions in the Civil Code, or provision for the homeowner's appeal to be heard by some qualified hearing officer trained to deal with such cases in some presently existing or newly created governmental agency. Providing for such review procedures might well tend to promote fair and correct resolution of contested legal issues at an earlier stage of the architectural review proceedings. In no event should the ultimate conflict resolution function be assigned or left to the board of directors, as the directors can almost certainly be counted on to ratify the decisions of their own ARC, without affording the affected homeowner the fair, objective, and honest review to which the homeowner should be considered to be entitled. Whatever review procedures are deemed appropriate for the foregoing purposes should be set forth in the legislation mandating ARC procedures.

3. Governmental oversight and powers of adjudication and sanctions. In order to deal with the possibility that some homeowners' associations and their boards of directors will fail to comply with requirements for establishing and/or following mandated procedures, and because the offended homeowners would be left with no possible remedies short of court action against a homeowners' association with the cards stacked in its favor if there is no other governmental body to which homeowners can take their grievances, there is an overwhelming need for a separate governmental entity (perhaps as a division or agency within some larger existing entity such as the Department of Real Estate, Consumer Affairs, or the office of the Attorney General) with dedicated responsibility for matters involving governance and related matters pertaining to common interest developments. With a reported 36,000-plus CIDs in California, more being created each week, and the endless myriad of problems and abuses that accrue and are reported virtually every day of the year, the need for an independent agency to deal with CID matters and problems would seem to be undeniable. Such agency should have enforcement powers to compel compliance with its rules and with statutory provisions applying to CIDs. Such powers should include administrative adjudications and the imposing of sanctions. Funding for the operation of the new agency in the present fiscal circumstances should probably be accomplished by fees and assessments imposed on entities subject to the agency's jurisdiction and, perhaps, on individual homeowners who will be the beneficiaries of the agency's functions and services. It is realized that this recommendation goes far beyond the scope of recommendations pertaining directly to AB 2376, but it is noted here because of its importance in developing a complete plan for dealing with matters relating to the governance of common interest developments in California.

Unless and until the foregoing recommendations are fully implemented and brought on line, there will continue to be serious problems in the governance of common interest developments and abuses of homeowners and their legal rights by their associations and developers. The reforms are sorely needed, and it is definitely time to

proceed with the necessary remedial legislation in order to level the playing field and promote procedures and requirements that should tend to yield honest, fair, and legally correct decisions in matters affecting the inherent property rights of homeowners.

Sincerely,

/s/ Patrick L. McLane
Patrick L. McLane

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Lincoln, California 95648-8731
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Attachment

cc: Brian Hebert, CLRC [bhebert@clrc.ca.gov]
Ellen Corbett, Chair and Members of the Assembly Judiciary Committee
ATTN.: Kevin Baker, Assembly Judiciary Committee [kevin.baker@asm.ca.gov]

PROPOSED ADDITION TO AB 2376 (SEC. 2, ADDING SECTION 1378 TO THE CIVIL CODE) TO SPECIFY PROCEDURES FOR HANDLING LEGAL ISSUES REQUIRING CONSIDERATION IN THE DECISION-MAKING PROCESS

The present draft of Section 1378 (a) (1) reads as follows: *"(1) The association shall provide a fair, reasonable, and expeditious procedure for making its decision. The procedure shall be included in the association's governing documents."*

In order to assure that legal issues inherent or raised in connection with any application for approval are fully and fairly considered, and to promote and assure legally correct decisions, the process needs to include a fair procedure for considering and resolving such legal issues. As such objective cannot be presumed to be accomplished by the general language of Subsection (1), nor can it be presumed that such general language is sufficient to assure that the needed procedures will be adopted and/or followed in every case, it is essential that the general language of said Subsection (1) be supplemented by the following additional provision. The proposed additional language could be placed (a) between the two sentences of Subsection (1), (b) at the end of Subsection (1), or (c) in a new Subsection (2) (and changing the numbering of the subsequent subsections as necessary). The proposed addition should read as follows:

In the event a legal issue (or issues) involving the interpretation, applicability, or application of any provision(s) of the governing documents, or of any other rules, regulations, or guidelines, is (are) raised and/or contested by either participant (i.e. the association [whether acting through an architectural review committee, the board of directors, or otherwise] or the resident applicant), each participant shall identify the issue(s) and present such participant's legal argument(s) with respect to such issue(s) in writing, and each participant shall have the right to respond to the legal argument(s) of the other participant in writing. The association shall make each request for a legal opinion to its attorney in writing, shall furnish such attorney with all pertinent submissions by the applicant, and shall furnish the applicant with a copy of the request to the attorney, a list of the documents and materials furnished to the attorney for such attorney's consideration, and full, unredacted copies of all opinions obtained from such attorney. Following such exchange of legal opinions, if the association elects to deny the application and the applicant disagrees with the association's position with respect to any legal issue pertinent to such denial, and the denial by the association is upheld on appeal by the applicant to the board of directors, the applicant may require that the legal issue(s) be referred to a qualified [hearing officer in the Department of Real Estate] for review and disposition.

The reference to "a hearing officer in the Department of Real Estate" is bracketed to indicate that referral to such an officer may not be the preferred course of action. The point is that there **needs** to be provision for referral of disputed legal issues to some legally competent, independent, and mutually acceptable third party in order to avoid and prevent the abuse of not giving proper consideration to the legal positions asserted by the applicant. Also, provision needs to be made to insure full compliance in a timely manner.