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Memorandum 2008-43

Legislative Program: AB 1921 (Saldaña)

This memorandum discusses the status of Assembly Bill 1921 (Saldaña), which would implement the Commission's recommendation on *Statutory Clarification and Simplification of CID Law* (Dec. 2007).

The memorandum also discusses a letter received from a group of 25 attorneys who specialize in Common Interest Development ("CID") law (the "Attorney Group"). The letter is attached at Exhibit pp. 1-21.

Except as otherwise indicated, statutory references in this memorandum are to the Civil Code.

STATUS OF BILL

The Commission developed the proposed law over two and a half years of open public meetings, with all materials widely distributed to interested groups and individuals. Unfortunately, many of the groups and individuals that received the Commission's materials did not raise objections to the proposed law until after AB 1921 had been introduced.

Considerable staff resources were required to address those late arising concerns, and a number of amendments were made. Most of the amendments were made to reverse substantive changes to existing law that the Commission had thought to be noncontroversial.

The time involved in working with the various interest groups delayed the bill in the Assembly. This led to a very short time for consideration of the bill in the Senate. The bill was referred to two policy committees. Each committee would have had little more than a week to review the 244 page bill.

That would have been unworkable at the best of times, even if the bill had been entirely nonsubstantive and unopposed. That was not the case. Despite repeated pruning, the bill still included some substantive changes that the committees would have needed to analyze, and still faced the active opposition

of the Attorney Group (discussed below). What's more, both committees faced extremely long agendas and their resources were stretched thin.

The staff was informally asked to withdraw the bill, for possible reintroduction next year (when it could proceed as a two-year bill if need be). That request was reasonable. After consulting the Commission's Chair, the staff asked Ms. Saldaña to withdraw the bill. She did so on June 10, 2008. **The staff appreciates all of the work that she and her staff put into the bill and regrets the complications that have surrounded the bill.**

ATTORNEY GROUP LETTER

On June 11, 2008, the staff received a copy of an opposition letter from the Attorney Group.

Although the input was welcome, the timing and distribution of the Attorney Group letter was unfortunate. When the bill was heard in the Assembly Judiciary Committee, on May 6, 2008, Chairman Jones instructed the Attorney Group to prepare a list of its specific concerns no later than mid-May, and provide them to Ms. Saldaña so that she could work to address them. Ideally, that would have allowed the bill to be amended to address the concerns before the bill reached the Senate.

Rather than provide the letter directly to Ms. Saldaña, at a time when amendments could have been made without burdening Senate resources, the Attorney Group did not distribute its letter until after the bill reached the Senate, and then delivered it directly to the members and staff of the Senate Committees on Judiciary and Transportation & Housing. The letter was widely distributed. See Exhibit pp. 18-19.

Despite the problematic timing, the staff appreciates receiving the Attorney Group's letter and having a chance to analyze and respond to its concerns. The issues raised in the letter are discussed below, in roughly the order in which they appear in the letter. The issues fall into three categories:

(1) In some places, the Attorney Group points out errors or raises policy objections to substantive changes. In the discussion below, the staff has recommended revisions to address those issues.

(2) In other places, the Attorney Group does not fully explain its concern. The staff encourages the Attorney Group to provide additional information as indicated below.

(3) Finally, a number of issues in the letter appear to be based on Attorney Group errors. The staff would appreciate it if the Attorney Group could review those points and either confirm that the staff's conclusion is correct, or provide additional explanation.

GENERAL COMMENTS

The Attorney Group begins its letter with harsh general criticism of the bill and the Commission:

> In every instance in which this bill was discussed by the California Law Revision Commission, its memoranda and comments reiterate that the purpose of this measure was solely to "reorganize, simplify and clarify" the law. None of these goals has been met, and the opposite can in fact be said. Badly off its aim and despite the limited billing it gave its effort, the CLRC felt compelled to break apart and reword virtually every provision of the Davis-Stirling Common Interest Development Act (Civil Code § 1350 et seq.). Passages that have nothing wrong with them, that have stood the test of time, that are cited in published cases, and that today resound in thousands of existing governing documents are now paraphrased, missing, moved, broken up, or devoid of context. The meaning and effect of existing law are jeopardized over and over again without apparent benefit.
>
> The law is *not* made clearer or simpler. Our analysis shows that this restatement is complicated, labyrinthine in places, marred by hundreds of cross-references, and full of unintended results. Provisions that should have been clarified are not. Despite its limited goals, the CLRC chose to add new concepts, create new burdens and liabilities for associations and their directors, insert new impediments that are unfriendly to the operations of community associations as businesses, and did not evaluate the cost.

See Exhibit pp. 1-2 (emphasis in original, footnote omitted).

The Attorney Group then seeks to support these general assertions with concrete examples. Exhibit pp. 2-18. The remainder of this memorandum focuses on the concrete examples proffered by the Attorney Group, because the general assertions are based on those examples.

Before turning to those specific examples, it is worth briefly discussing two of the general objections noted above: paraphrasing and cost.

Paraphrasing

In order to make the law easier to read and understand, the proposed law would restate many of the provisions of the Davis-Stirling Act. That sort of

clarification is especially important for homeowners, who are not attorneys and may find the existing language difficult to understand.

Any effort of this type is susceptible to criticism, from both directions. Some critics will feel that too much change has been introduced. Others will complain that too much of the existing language has been preserved. The Commission has received both types of criticism.

In some instances, the Commission has restated difficult language to make it easier to understand, without intending to affect its substance. The Commission has relied on expert review of such changes to highlight any that might be problematic. **We continue to invite such review and constructive criticism.** If the Attorney Group can point to specific instances where it believes that restatement of existing language would affect the substance of the law, the staff will work to address the concern.

Cost of the Proposed Law

Any significant reorganization of a body of law will result in transitional costs, primarily as a consequence of section renumbering. Consequently, such changes are often resisted by existing experts who understand the current law and do not want to learn a new system.

Most homeowners do not fall into that category. They may have no knowledge of existing law at all. Changes in organization and section numbering will have no effect on those laypersons. To them, what matters is that the law be well organized and understandable when they need to consult it.

That is the purpose of the proposed law. The benefits will mostly accrue to CID homeowners. The transitional costs will fall most heavily on expert practitioners (who are best able to absorb it).

However, there are some unavoidable transitional costs that the Commission recognizes. They are discussed briefly below.

Revision of Governing Documents

Some existing CID governing documents include statutory cross-references. If the referenced sections are renumbered, then the references to those sections may need to be revised. Such revisions could be procedurally costly, because amendment of the governing documents often requires a member election.

The proposed law addresses that problem, in two ways. First, proposed Section 4010(b) provides:

> A reference in an association's governing documents to a former provision that is restated and continued in this part shall be deemed to include a reference to the provision of this part that restates and continues the former provision.

That would eliminate any legal necessity to revise a statutory cross-reference.

Second, proposed Section 6010 would allow an association to correct statutory cross-references in governing documents by board resolution, eliminating the need for a member election:

> 6010. If the governing documents include a reference to a former provision of the Davis-Stirling Common Interest Development Act that is continued by a current provision of the act, the board may amend the governing documents, solely to correct the statutory reference, by adopting a board resolution that clearly shows the proposed correction.

Taken together, those provisions would significantly reduce the cost of correcting governing documents to reflect the changes made by the proposed law. **The staff is open to suggestions for other economizing measures.**

Revision of Department of Real Estate ("DRE") Regulations

Some DRE regulations refer to specific statutory provisions. Those references would need to be corrected if the proposed law were enacted. However, those sorts of changes are routine, and need to be made continually as bills make changes to CID law. The staff has been informed that DRE is currently planning an overhaul of its CID regulations. Any changes required as a result of the proposed law could be addressed at that time.

Despite soliciting comment from DRE, the Commission has not been informed by DRE that the proposed law would be problematic. Informal DRE staff responses have generally been favorable.

Treatise Revision

Treatises on California CID law would need to be comprehensively rewritten. That would impose significant costs on the authors of those treatises, which might not be fully reimbursed (the staff understands that treatise authors often work for honoraria). This concern may explain some of the opposition from the seven signatories of the Attorney Group letter who are authors of CID treatises. Similarly, the Commission has received vehement opposition from Donie Vanitzian, who also authors a CID treatise.

Case Law Research

Whenever a body of law is renumbered, case law research becomes more complicated. Courts must reference both the old section and the new in writing their opinions.

Prior Commission experience with the Probate Code, Family Code, and other smaller bodies of law that were recodified on the Commission's recommendation suggest that the cost is manageable and passes with time.

PROCESS CONCERNS

The Attorney Group complains that the proposed law was prepared without adequate input from legal experts, and that the Commission is "wholly resistant to requests for measured review" of the bill. See Exhibit p. 1.

> We have been criticized for not staying closer to the CLRC's processes. Right or wrong, we trusted the CLRC to do only what it said. Had we been asked, we would also have trusted that when a complete restatement of *any* law is actually planned, a Commission whose singular charge is to revise law would *require* the use of legal consultants who practice in the field. We would trust that it would not simply rely on whatever comments were volunteered, and also that the CLRC should have known that the limited response it received from legal professionals in our field was not an adequate vetting of the deep changes that were afoot.

See Exhibit p. 2 (emphasis in original).

It is difficult for the staff to reconcile those complaints with the history of the Commission's work on this project.

Solicitation of Experts

The Commission sought the input of CID legal experts on this project in the same manner that it has in prior CID projects, by working closely with the principal CID trade groups (Executive Council of Homeowners ("ECHO"), Community Associations Institute, and California Association of Community Managers). Many of the signatories of the letter are affiliated with one or more of those groups.

Materials were also provided to the Department of Real Estate, the California Association of Realtors, a number of individual attorneys, senior groups, and professional managers. The Commission's distribution list had over 450 recipients.

None of these organizations expressed any serious reservations about the project during the Commission's study or afterward. None opposed AB 1921. Despite the affiliations of many of the signatories, the Attorney Group's letter does not reflect the official position of any formally organized group.

In addition, the Commission's materials were posted on its website. All of the Commission's meetings were open to the public, and the Commission encouraged members of the public to participate in the discussions and submit written comments.

The Commission reviewed and took into account over 300 pages of public comments during the study, including over 140 pages of comments from 8 CID attorneys. The Commission considered the topic at numerous public meetings before it approved a final recommendation, and at several more meetings afterwards. At each of those meetings, the Commission heard from stakeholders and other interested persons.

The staff prepared many extensive memoranda for the Commission to consider, *all of which contained proposed statutory language*. Those memoranda were distributed and posted to the Commission's website as discussed above. In evaluating those materials and the other input, the Commissioners drew on their own legal expertise and experience, including significant expertise on California real property law.

Attorney Group Participation in Commission Process

At least eight of the Attorney Group signatories were on the Commission's mailing list throughout the study. They received notice of every memorandum as it became available (which included a running cumulative draft of the proposed legislation) and notice of the tentative recommendation, which solicited public comment on the proposed law.

Another of the signatories, Adrian J. Adams, was mailed copies of the Commission's tentative recommendation and specifically requested to review and comment on the proposal. He advertised the Commission's tentative recommendation on his CID-related website, but did not submit any comments.

Curtis Sproul, Attorney Group signatory and co-chair of the CID Subsection of the Real Property Law Section of the State Bar, commented extensively throughout the Commission's deliberative process.

Sandra Bonato, the principal signatory of the Attorney Group letter, was on the legislative review committee of ECHO when the project commenced and

during most of its development. Ms. Bonato has attended numerous Law Revision Commission meetings and is familiar with the Commission's process.

Two other signatories, Jeffrey Barnett and John Garvic were also on ECHO's legislative committee. Mr. Garvic and another signatory, Steven Weil, were on ECHO's board of directors.

ECHO had representatives at all but one of the Commission meetings at which this study was considered. The staff has been informed that the Commission's project was discussed at every ECHO board and legislative committee meeting, over its two and a half year duration. At those meetings, the ECHO-affiliated signatories were repeatedly urged to review the Commission's materials and submit comments. Only one of them did, Jeffrey Barnett, who wrote in response to the tentative recommendation:

> I am aware that this Draft is the result of a tremendous amount of time and effort. The need for statutory reform is apparent, and I applaud your efforts and practical approach to the task.

See Memorandum 2007-47, Exhibit p. 52.

Process after Introduction of AB 1921

Once the Commission completed its study and Assembly Member Saldaña introduced AB 1921, the Commission continued to refine the proposed legislation in response to public input. The Commission made an open-ended commitment to every interest group, to work to address their concerns about the bill. The Commission fully honored that commitment for every group that provided a list of specific concerns.

The Attorney Group did not state its specific concerns until it was too late to address them, contrary to the instructions of the Chair of the Assembly Judiciary Committee. Had those concerns been stated earlier, the Commission would have worked to address them.

In its first letter, dated April 18, 2008, the Attorney Group asked that the bill be withdrawn and referred to the State Bar for analysis, with possible reintroduction in 2009. See First Supplement to Memorandum 2008-12, Exhibit pp. 1-2.

The Commission's staff was reluctant to withdraw the bill in April for three reasons:

(1) The Attorney Group had not specifically identified any serious problems in the bill. Most of their complaints about the bill were based on unsupported general assertions only.

(2) The staff had good reason to believe that at least some members of the Attorney Group were opposed to *any* attempt to recodify CID law.

(3) Many in the Attorney Group had ignored the Commission's process, despite being aware of the nature of the proposed law and the likelihood that implementing legislation would be introduced.

In light of those facts, the staff was concerned that the request for delay was simply an attempt to kill the bill. If the bill were taken off calendar for a year, the pressure to work with the Commission to improve the bill would also be removed. It seemed possible that the Attorney Group would simply wait until the bill was reintroduced in 2009 and then renew its opposition. Keeping the bill moving put pressure on the Attorney Group to analyze the bill and articulate specific concerns, as they have now done.

Given the withdrawal of the bill, the Attorney Group now has the time that it originally requested, and can carefully analyze the bill and assist the Commission in fixing any problems.

STRUCTURE AND SCOPE OF THE PROPOSED LAW

The Attorney Group has a number of concerns about the organization and scope of the proposed law. Those issues are discussed below.

"Massive Expansion" of the Law

In a number of places, the Attorney Group complains that the proposed law would expand the size of the Davis-Stirling Common Interest Development Act ("Davis-Stirling Act"). The group claims that the proposed law "took 87 sections of concise law, broke them up and spread them out over nearly 3,000 sections." See Exhibit p. 3. This is described as a "massive expansion" of the law, which would make it "far too large." See Exhibit p. 7. The group then asserts that existing law can be "read in a few hours" but that the proposed recodification "might (possibly) be read in a few days."

The reference to "3,000 sections" is misleading. There are actually 211 sections in the proposed law as recommended by the Commission. The reference to 3,000 sections may have been an exaggerated reference to the fact that the section *numbers* used in the proposed law span from 4000 to 6215.

The spread in section numbering is intentional. In general, the sections were numbered by fives (i.e., Section 4000 is followed by 4005, then 4010, 4015, etc.). This allows space in the law for future "infill" development. In the absence of such spacing, sections often get shoehorned in with decimal extensions. See, e.g., Civ. Code §§ 1363.001, 1365.2.5. For the same reason, numbering gaps were intentionally left at the end of some articles and chapters. This allows for future growth or insertions.

This reflects standard Commission drafting style, developed over many years. It has the benefits stated above. The staff sees no disadvantages.

It is correct that the actual number of sections in the proposed law would be more than twice the number of sections in the existing statute (211 as opposed to 87). However, many of the existing sections are far from concise. Some sections run for multiple pages or address multiple subjects. The proposed law breaks those unwieldy sections into a larger number of smaller provisions, each addressing a narrower concept.

That approach is consistent with the Commission's longstanding general drafting practice, derived from its predecessor, the California Code Commission. Both the Legislative Counsel and the Legislature itself have also formally expressed a preference for short code sections. See Joint Rule 8; 2007 Cal. Stat. res. ch. 2. That drafting technique has many advantages, as more fully explained in the Commission's recommendation on *Civil Discovery: Nonsubstantive Reform*, 33 Cal. L. Revision Comm'n Reports 789, 793-95.

The staff does not see any inherent problem, and does see significant advantages, that would result from having a larger number of smaller sections.

Finally, it is not clear why the Attorney Group feels that the proposed law would take days to read, while the existing Davis-Stirling Act would take only a few hours. Reading time is determined by the number of words, not the number of sections or the span of section numbers used. The existing Davis-Stirling Act has approximately 37,000 words. The proposed recodification of the Davis-Stirling Act, which includes some provisions from the Corporations Code, has approximately 38,000 words. That is around a two and a half percent increase in the number of words.

The staff does not believe that there has been any meaningful or problematic increase in the size of the Davis-Stirling Act.

Location of Governing Document Provisions

The Attorney Group feels strongly that governing document provisions should be located at the beginning of the proposed law and that it is illogical and confusing to place them at the end of the proposed law, as the Commission proposed. See Exhibit pp. 3-4. The group cites the Uniform Common Interest Ownership Act ("UCIOA") as an example of a statute that follows the Attorney Group's preferred organization:

> As an act to regulate common interest communities, UCIOA appropriately addresses *real property principles* before it delves into membership issues of governance or operations. So too did the original Davis-Stirling Act. In the proposed new Act, however, corporate or operational issues of *associations* predominate over the protection of property interests in *common interest developments*. Chronologically and organizationally, this is out of order.

Id. at 4 (emphasis in original). The group feels that provisions governing the development and creation of CIDs should not be placed near the end of the proposed law "where finding them becomes serendipitous." They describe this as a "fundamental problem" that will cause "serious and costly mistakes." In particular, the group is concerned about "attorneys who advise developers," who are less concerned about "ongoing operations of existing communities" than they are about "their origination and creation." *Id.*

That is an understandable preference. However, there are other choices that have equal merit but are aimed at different objectives. The organization of the proposed law was intentionally chosen to better serve *homeowners*, who are more concerned with the ongoing operation of their communities than with the process of development and creation (which necessarily occurs before there are any homeowners). As explained in the first memorandum in this study:

> In addition, we should consider reorganizing the Davis-Stirling Act to make it more accessible to CID homeowners. The outline below offers one possible approach, with provisions relating to member rights and duties near the front of the Act, followed by provisions on the governing association and finances. Matters of less day-to-day importance are toward the end.
>
> …
>
> There are, of course, other organizing principles that could be used. *The staff invites suggestions on how to make the organizational structure more intuitive and clear.*

Memorandum 2005-18, p. 4 (emphasis added). As noted, that approach is intended to facilitate understanding by layperson homeowners. Frankly, the staff is more concerned about homeowner understanding of the law than it is about the risk that development attorneys will be unable to find the provisions on governing documents (which seems very unlikely).

Should the proposed law be restructured to move the governing document provisions to the front of the proposed law?

Separation of Provision on Application of the Act from Provision on Creation of CID

In questioning the location of the governing document provisions, the Attorney Group notes that existing Section 1352 conditions the creation of a CID (and the application of the Davis-Stirling Act) on the conveyance of a separate interest. See Exhibit pp. 6-7. The Attorney Group expresses concern about the idea of separating the provision governing the application of the Davis-Stirling Act (proposed Section 4015) from the provision stating the requirements for creation of a CID (proposed Section 6000). *Id.* The Attorney Group warns that confusion might arise as to whether the Davis-Stirling Act applies to a CID that exists only on paper.

That is a good point, which the Commission has already addressed. See First Supplement to Memorandum 2008-12, pp. 3-4. The Commission ratified the amendment described in that memorandum, which had already been made in the printed bill as of May 22, 2008:

> 4015. (a) This part applies to a common interest development <u>that is created pursuant to Section 6000</u>.

By adding a cross-reference, the amendment makes clear that the Davis-Stirling Act does not apply to a CID that has not yet been created pursuant to the requirements of Section 6000.

Location of "Preliminary Provisions"

The Attorney Group feels that it is illogical and confusing to begin the proposed law with a chapter of preliminary provisions. The group says that: "the first 70 sections of the CLRC's proposed new law are a jumble of disassociated terms and concepts (under the rubric of 'general provisions'), ranging from discussions of nonresidential developments, to references to zoning, to quorums of association members, to how notice gets delivered." See Exhibit pp. 4-5.

Actually, there are 15 sections in the article entitled "General Provisions." They include the short title of the Act, some rules of construction and application, and some general default rules on notice delivery and member approval procedures.

It is the Commission's longstanding drafting practice to place general rules of construction, definitions, and application provisions at the beginning of a large body of law. See, e.g., the Enforcement of Judgments Law (Code Civ. Proc. §§ 680.00-694.090); the Evidence Code (Evid. Code §§ 1-413); the Health Care Decisions Law (Prob. Code §§ 4600-4665). The practice is also fairly common in portions of the codes that were not drafted by the Commission. See, e.g., the Nonprofit Corporations Law (Corp. Code §§ 5002-5080).

The staff is not persuaded that placing preliminary provisions of this type within a discrete chapter at the beginning of the proposed law would cause problems. If the Commission disagrees, the provisions could be moved elsewhere.

COORDINATION OF THE CORPORATIONS CODE AND THE DAVIS-STIRLING ACT

One of the more confusing aspects of CID law is the overlap between the Corporations Code and the Davis-Stirling Act. Both bodies of law may apply and address the same subject, in similar but inconsistent ways.

This means that a homeowner, board member, or CID professional must read the two bodies of law side-by-side and reconcile them in order to understand what the legal requirements are for a particular matter. That task is complicated by provisions in the Davis-Stirling Act that specifically incorporate portions of the Corporations Code, *even if a homeowner association is unincorporated* (see, e.g., Section 1366(b), and other provisions that *preempt the Corporations Code to the extent of any conflict* (see, e.g., Section 1363.03(n)).

The Commission considered three ways that this overlap in governing authority might be addressed:

(1) Do nothing.
(2) Declare the entire Corporations Code inapplicable to homeowner associations and import all of the relevant substance of that code into the Davis-Stirling Act.
(3) Take a hybrid approach. Portions of the Corporations Code that do not overlap the substance of the Davis-Stirling Act would be left in

> place; portions that do overlap would be declared inapplicable and their substance would be imported into the Davis-Stirling Act.

The Commission chose the third approach. There are portions of the Corporations Code that do not overlap with the Davis-Stirling Act in any way, and the Commission decided to leave those provisions undisturbed. See, e.g., Corp. Code §§ 5002 *et seq* (preliminary provisions), 7110 *et seq* (organization and bylaws), 7710 *et seq* (members' derivative actions), 7810 *et seq* (amendment of articles), 7910 *et seq* (sale of assets), 8010 *et seq* (mergers), 8410 *et seq* (service of process), 8510 *et seq* (involuntary dissolution), 8610 *et seq* (voluntary dissolution). Those provisions are sound, do not conflict or overlap with the Davis-Stirling Act, and need not be disturbed.

In other areas, the overlap between the Davis-Stirling Act and the Corporations Code is extensive and potentially confusing. In those cases, the proposed law would declare a portion of the Corporations Code inapplicable and would import the relevant substance into the Davis-Stirling Act, as follows:

> 4025. (a) Except as otherwise provided, an association that is incorporated is governed by this part and by the Corporations Code.
>
> (b) The following provisions of the Corporations Code do not apply to an association, unless a provision of this part expressly provides otherwise:
>
> (1) Sections 5211 and 7211.
>
> (2) Chapter 5 (commencing with Section 5510) of Part 2 of, and Chapter 5 (commencing with Section 7510) of Part 3 of, Division 2.
>
> (3) Sections 5610, 5611, 5612, 5615, 5617, 7610, 7611, 7612, 7614, and 7616.
>
> (4) Chapter 13 (commencing with Section 6310) of Part 2 of, and Chapter 13 (commencing with Section 8310) of Part 3 of, Division 2.
>
> (c) An association that is not incorporated is governed by this part and by any provision of the Corporations Code that is applicable pursuant to this part.

The Attorney Group finds this provision to be "largely incomprehensible." See Exhibit p. 5.

The staff acknowledges that the meaning of the section might be lost on some readers, because the provisions of subdivision (b) are removed from the subject matter that they address. **The staff recommends that the Commission retain its hybrid approach, but distribute the content of proposed Section 4025(b) to more relevant locations within the proposed law.**

The first step in implementing this approach would be to revise Section 4025 as follows:

> 4025. (a) Except as otherwise provided, an association that is incorporated is governed by this part and by the Corporations Code.
>
> (b) ~~The following provisions of the Corporations Code do not apply to an association, unless a provision of this part expressly provides otherwise:~~
>
> ~~(1) Sections 5211 and 7211.~~
>
> ~~(2) Chapter 5 (commencing with Section 5510) of Part 2 of, and Chapter 5 (commencing with Section 7510) of Part 3 of, Division 2.~~
>
> ~~(3) Sections 5610, 5611, 5612, 5615, 5617, 7610, 7611, 7612, 7614, and 7616.~~
>
> ~~(4) Chapter 13 (commencing with Section 6310) of Part 2 of, and Chapter 13 (commencing with Section 8310) of Part 3 of, Division 2.~~
>
> ~~(c)~~ An association that is not incorporated is governed by this part and by any provision of the Corporations Code that is made applicable pursuant to this part.
>
> **Comment**. Section 4025 is new. For provisions exempting homeowner associations from portions of the Corporations Code, see Sections 4502, 4575, 4625, 4702.

Next, the Commission should add a new Section 4502 near the beginning of the article on board meetings:

> 4502. A board meeting is not governed by Corporations Code Section 5211 or 7211.

The Commission should also add new subdivision (e) to proposed Section 4575, relating to the conduct of member meetings:

> 4575.… (e) A member meeting is not governed by Chapter 5 (commencing with Section 5510) of Part 2 of, and Chapter 5 (commencing with Section 7510) of Part 3 of, Division 2 of the Corporations Code.

The Commission should revise proposed Section 4625, which governs member elections, as follows:

> 4625. (a) This article governs a member election. This article does not govern a vote of directors or other appointed or elected officials.
>
> (b) A member election is not governed by Chapter 6 (commencing with Section 5610) of Part 2 of, and Chapter 6 (commencing with Section 7610) of Part 3 of, Division 2 of the Corporations Code, except as follows:

(1) Section 5614 of the Corporations Code applies to an association that is organized as a nonprofit public benefit corporation.

(2) Sections 7613 and 7615 of the Corporations Code apply to an association that is organized as a nonprofit mutual benefit corporation.

Finally, the Commission should add a new Section 4702 near the beginning of the article on record inspection:

> 4702. Record inspection is not governed by Chapter 13 (commencing with Section 6310) of Part 2 of, and Chapter 13 (commencing with Section 8310) of Part 3 of, Division 2.

Those changes would make the preemption of the Corporations Code provisions much easier to understand than at present. **The staff recommends that the Commission approve the changes.**

The Attorney Group also seems to be arguing against *any* incorporation of the Corporations Code provisions into the Davis-Stirling Act. See Exhibit p. 6. They believe doing so would actually complicate matters for homeowners.

With the changes proposed above, the staff does not see how that could be the case. A homeowner reading the law on a particular topic (e.g., member meetings) would be immediately alerted that the Corporations Code chapters on member meetings do not apply. All of the law governing a member meeting would be found in the Davis-Stirling Act.

That is a much simpler arrangement than existing law, which requires that the Davis-Stirling Act and Corporations Code be read together, and overlapping provisions harmonized. That could prove very difficult. For example, if a homeowner wishes to contest an election in court, do they proceed under Section 1363.09 or Corporations Code Section 7616? Both sections apply, and state substantively different rules.

The problems associated with the overlap between the Corporations Code and the Davis-Stirling Act are significant and need to be addressed. They create a trap and an obstacle to understanding. The proposed law would largely eliminate those problems.

ASSESSMENT INCREASES

Existing Section 1366(a)-(b) establishes an association's duty to impose assessments "sufficient to perform its obligations under the governing

documents and this title." The provision also imposes member approval requirements on the increase or imposition of assessments in some circumstances:

> 1366. (a) Except as provided in this section, the association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title. However, annual increases in regular assessments for any fiscal year, as authorized by subdivision (b), shall not be imposed unless the board has complied with subdivision (a) of Section 1365 with respect to that fiscal year, or has obtained the approval of owners, constituting a quorum, casting a majority of the votes at a meeting or election of the association conducted in accordance with Chapter 5 (commencing with Section 7510) of Part 3 of Division 2 of Title 1 of the Corporations Code and Section 7613 of the Corporations Code. For the purposes of this section, "quorum" means more than 50 percent of the owners of an association.
>
> (b) Notwithstanding more restrictive limitations placed on the board by the governing documents, the board of directors may not impose a regular assessment that is more than 20 percent greater than the regular assessment for the association's preceding fiscal year or impose special assessments which in the aggregate exceed 5 percent of the budgeted gross expenses of the association for that fiscal year without the approval of owners, constituting a quorum, casting a majority of the votes at a meeting or election of the association conducted in accordance with Chapter 5 (commencing with Section 7510) of Part 3 of Division 2 of Title 1 of the Corporations Code and Section 7613 of the Corporations Code. For the purposes of this section, quorum means more than 50 percent of the owners of an association. This section does not limit assessment increases necessary for emergency situations. For purposes of this section, an emergency situation is any one of the following:
>
> (1) An extraordinary expense required by an order of a court.
>
> (2) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the association is responsible where a threat to personal safety on the property is discovered.
>
> (3) An extraordinary expense necessary to repair or maintain the common interest development or any part of it for which the association is responsible that could not have been reasonably foreseen by the board in preparing and distributing the pro forma operating budget under Section 1365. However, prior to the imposition or collection of an assessment under this subdivision, the board shall pass a resolution containing written findings as to the necessity of the extraordinary expense involved and why the expense was not or could not have been reasonably foreseen in the budgeting process, and the resolution shall be distributed to the members with the notice of assessment.

The proposed law would restate those provisions as follows:

> 5575. (a) An association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title.
>
> …
>
> **Comment**. Subdivision (a) of Section 5575 continues the first sentence of former Section 1366(a) without substantive change.
>
> …
>
> 5580. (a) Subject to the limitations of Section 5575 and subdivision (b), the board may increase the regular assessment by any amount that is required to fulfill its obligations and may impose a special assessment of any amount that is required to fulfill its obligations. This subdivision supersedes any contrary provision of the governing documents.
>
> (b) In the following circumstances, an assessment increase or special assessment may only be adopted with the approval of an affirmative majority of the votes cast in a member election at which at least fifty percent of the voting power is represented:
>
> (1) The association has not complied with Section 4800 for the fiscal year in which the assessment increase or special assessment would take effect.
>
> (2) The total increase in the regular assessment for the fiscal year would be more than 20 percent of the regular assessment for the preceding fiscal year.
>
> (3) The total for all special assessments imposed in the fiscal year would be more than 5 percent of the budgeted gross expenses of the association for the fiscal year in which the special assessment would be imposed.
>
> (c) Subdivision (b) does not apply to an assessment increase that is required to address the following emergency expenses:
>
> (1) An extraordinary expense required by an order of a court.
>
> (2) An extraordinary expense necessary to repair or replace any part of the development that the association is obligated to maintain, where a threat to personal safety is discovered on the property.
>
> (3) An extraordinary expense necessary to repair or replace any part of the development that the association is obligated to maintain that could not have been reasonably foreseen by the board in preparing and distributing the budget report under Section 4800. Before imposing an assessment under this subdivision, the board shall adopt a resolution containing written findings as to the necessity of the extraordinary expense involved and why the expense was not or could not have been reasonably foreseen in the budgeting process, and the resolution shall be distributed to the members with the notice of assessment.
>
> …

> **Comment**. Subdivisions (a)-(c) and (e) of Section 5580 restate the last two sentences of former Section 1366(a), and former Section 1366(b), without substantive change. Subdivision (a) makes clear that a board's authority to impose an assessment increase that is required to fulfill its legal obligations may not be limited by the governing documents.
>
> …

The Attorney Group expressed the following concerns about that approach.

Mandatory Full Funding of Reserves

Subdivision (a) of existing Section 1366 requires that a board "levy regular and special assessments sufficient to perform its obligations under the governing documents and this title." That duty is expressly qualified by an acknowledgment of the special member approval requirements stated in subdivision (b), which govern some assessment decisions: "Except as provided in this section …"

As shown above, the proposed law would not continue the phrase "Except as provided in this section…." Proposed Section 5575 would simply state that "[an] association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title."

The Attorney Group believes that this is a "momentous policy change" that would "cost homeowners billions of dollars." See Exhibit p. 8. Why? The Attorney Group seems to be suggesting that omitting the phrase would create an unrestricted duty to fully fund reserves. Under existing law, full funding of reserves is not required by law, and many associations are seriously underfunded.

For two reasons, the staff is not persuaded that the proposed law would create such a duty:

(1) The duty stated in proposed Section 5575 is only to impose assessments necessary to *perform obligations under the governing documents or the Davis-Stirling Act*. The asserted removal of an obstacle to increasing assessments would not itself create an affirmative duty to fully fund reserves. Existing statutory law does not impose such a duty. The proposed law would not add any new language to create such a duty.

(2) Although framed as a limitation on the association's *duty*, the omitted phrase ("Except as otherwise provided in this section…") is really just an acknowledgment of a *procedural* constraint: the board cannot impose an assessment increase or special assessment if member approval is required and the members do not approve.

> *Omission of the phrase would not affect that procedural constraint*. The constraint is self-executing. Under both the existing law and the proposed law, a board could not impose an assessment change that requires member approval if the members do not give their approval. Omission of the phrase in question ("Except as otherwise provided in this section…") would have no substantive effect on that outcome.

Perhaps the Attorney Group believes that other language in the proposed law would create a duty of full funding. If so, the group has not articulated that point clearly.

They do point out that proposed Section 5555 would use the term "total *required* balance." See Exhibit p. 8 (emphasis in original). In theory, that might be construed as imposing a *requirement* of full funding. However, existing law also uses the word "required" in related contexts. See Sections 1365(a)(3)(B), 1365.2.5(a)(6)-(7).

To the staff's knowledge, the current use of the term "required" in those provisions is not understood as imposing a rule of mandatory full funding of reserves. Nonetheless, a number of groups have asked that the term "required" be stripped from the reserve funding provisions, to avoid any confusion on the issue. **In cooperation with knowledgeable experts, the staff is exploring that suggestion as part of a general examination of financial terminology used in the Davis-Stirling Act.** We will report back to the Commission when the general examination of financial terminology is complete.

The staff does not believe that recodifying Section 1366(a)-(b) as shown above (as proposed Sections 5575 and 5580) would have any substantive effect, much less impose a new duty of mandatory reserve funding. Nonetheless, had the Attorney Group expressed this concern during the Commission's deliberative process, there would have been no reason to insist on omitting the phrase "Except as otherwise provided in this section…".

The same considerations apply now. **The staff recommends that proposed Section 5575(a) be revised as follows:**

> 5575. (a) ~~An~~ Except as provided in Section 5580, an association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title.

Impediment to Regular Assessment Increase

Under existing law, member approval of an assessment increase is required if the board did not provide the membership with the annual budget *as required by*

Section 1365(a). The proposed law has restated the reporting requirements of Section 1365(a) in proposed Section 4800. Thus, under the proposed law, member approval of an assessment increase is required if the board has not distributed the annual budget report *as required by proposed Section 4800*.

The content of proposed Section 4800 is stated differently than the content of the existing budget report required by Section 1365(a). As noted below, it also includes related material that is not technically part of the annual budget under existing law. For that reason, the Attorney Group is concerned that the proposed law would create new hurdles that must be cleared in order to impose an assessment increase without member approval.

The Attorney Group points to three requirements as problematic: (1) the requirement that the budget report include a statement of the estimated revenue and expenses for the reserve account, (2) the requirement that the budget report include the reserve funding study, rather than a "summary" of the study, and (3) the requirement that the budget report include information about the association's insurance coverage.

Statement of Estimated Revenue and Expenses for Reserve Account

The Attorney Group objects that proposed Section 4800 would require that the budget include "a statement of estimated revenue and expenses for the reserve account for the upcoming year." See Exhibit p. 9.

Under existing law, the annual budget must include "[the] estimated revenue and expenses on an accrual basis." Section 1365(a)(1). That provision does not distinguish between the operating and reserve accounts, so it could be read to already require revenue and expense detail for the reserve account, as provided in proposed Section 4800. Under that reading of existing law, the proposed law would not create any new requirement with respect to reporting the status of the reserve account.

However, existing law does not expressly state that such detail must be provided for the *reserve* account. **In order to avoid creating a new substantive requirement with respect to this issue, the staff recommends that existing law on the point be restored verbatim.** To accomplish that, proposed Section 4800(b) should be revised as follows:

> 4800. …
> (b) The annual budget report shall include all of the following information:

(1) The estimated revenue and expenses ~~for the operating and reserve accounts,~~ on an accrual basis.

(2) The current amount of accumulated cash reserves actually set aside to repair, replace, restore, or maintain major components.

(3) The reserve funding study prepared pursuant to Section 5555.

~~(3)~~ (4) A summary of the association's property, general liability, earthquake, flood, and fidelity insurance policies. For each policy, the summary shall include the name of the insurer, the type of insurance, the policy limit, and the amount of any deductible. To the extent that any of the required information is specified in the insurance policy declaration page, the association may meet its obligation to disclose that information by making copies of that page and distributing it with the annual budget report.

Inclusion of Reserve Funding Study Instead of "Summary of Reserves"

The Attorney Group also objects that Section 4800 would require the annual budget report to include the reserve funding study, rather than just a "summary of the association's reserves." See Exhibit p. 9.

Under existing law, the content of the required "summary of the association's reserves" is extensive, detailed, and covers much of the same information as the reserve study required under proposed Section 5555. See Section 1365(a)(2). This is a case where existing law requires the same general information to be provided twice, in significantly different formats. An association must prepare the reserve funding study, and then must prepare a separate "summary of the association's reserves."

The proposed law would simplify things by (1) ensuring that the reserve funding study includes all of the information that is required in the annual "summary of the association's reserves," and (2) requiring that the board provide a copy of the reserve study with the annual budget. Only one document would be prepared and distributed, rather than two. That should provide a significant benefit to associations, by eliminating an extra procedural step.

Because the proposed law would simplify an existing requirement, rather than creating a new one, it doesn't seem likely that it would cause new complications.

However, the staff would be interested to hear whether the Attorney Group opposes the substance of this change, or is simply concerned that it might cause problems for associations that stumble in the transition to the new procedure.

Inclusion of Insurance Information in Budget Report

Under Section 1365(f), information relating to the association's insurance coverage must be circulated on the same schedule as distribution of the annual budget, but is not *part* of the annual budget. Therefore, a failure to provide the required insurance information does not trigger the requirement that members approve an assessment increase (as a failure to provide the annual budget would do).

As an economizing measure, proposed Section 4800 provides for the insurance information to be incorporated into the annual budget report.

That change is nonsubstantive, but it has a substantive consequence when read together with proposed Section 5580(b)(1), which requires member approval of an assessment increase when an association has not complied with Section 4800. Under those provisions, a failure to provide insurance information would trigger the member approval requirement (which is not the case under existing law). That was a substantive change, which the Attorney Group opposes.

The staff recommends that proposed Section 5580(b)(1) be revised as follows, to restore existing law on this point:

> 5580. …
>
> (b) In the following circumstances, an assessment increase or special assessment may only be adopted with the approval of an affirmative majority of the votes cast in a member election at which at least fifty percent of the voting power is represented:
>
> (1) The association has not complied with the requirements of paragraphs (1) to (3), inclusive, of subdivision (b) of Section 4800 for the fiscal year in which the assessment increase or special assessment would take effect.
>
> …

That more complicated cross-reference would exclude the insurance information component of the annual budget report.

Impediment to Special Assessment

Section 1366(a) provides in part:

> … annual increases in regular assessments for any fiscal year, as authorized by subdivision (b), shall not be imposed unless the board has complied with [the annual budget report requirement] with respect to that fiscal year, or has obtained the approval of owners, constituting a quorum, casting a majority of the votes at a meeting or election of the association….

The Attorney Group notes that this requirement *does not currently apply to a special assessment*. See Exhibit p. 9.

Under the proposed law, the failure to give the annual budget report as required would trigger a member approval requirement for an annual increase of the regular assessment *or a special assessment*. See proposed Section 5580(b)(1). That would be a substantive change. See Exhibit p. 9. The Attorney Group opposes that change.

Consistent with the general approach of reversing substantive changes that are opposed, **the staff recommends that proposed Section 5580(b)(1) be amended as follows:**

> 5580. …
> (b) In the following circumstances, an assessment increase or special assessment may only be adopted with the approval of an affirmative majority of the votes cast in a member election at which at least fifty percent of the voting power is represented:
> (1) The association has not complied with Section 4800 for the fiscal year in which the assessment increase ~~or special assessment~~ would take effect. <u>This paragraph does not apply to a special assessment.</u>
> …

Assessment Increases and the Governing Documents

Existing Section 1366(b) provides, in relevant part, as follows:

> Notwithstanding more restrictive limitations placed on the board by the governing documents, the board of directors may not impose a regular assessment that is more than 20 percent greater than the regular assessment for the association's preceding fiscal year or impose special assessments which in the aggregate exceed 5 percent of the budgeted gross expenses of the association for that fiscal year without the approval of owners, constituting a quorum, casting a majority of the votes at a meeting or election of the association conducted in accordance with Chapter 5 (commencing with Section 7510) of Part 3 of Division 2 of Title 1 of the Corporations Code and Section 7613 of the Corporations Code. For the purposes of this section, quorum means more than 50 percent of the owners of an association. This section does not limit assessment increases necessary for emergency situations. …

The meaning of the "notwithstanding more restrictive limitations" qualification is not entirely clear from the face of the statute. See J. Hanna & D. Van Atta, California Common Interest Developments: Law and Practice § 19:37 (2008). ("Unfortunately, the language of Civil Code § 1366(b) is confusing. It

contains a double negative, and may be read to mean that more restrictive language in a declaration cannot be imposed on a project board.")

The confusing language used in Section 1366(b) was discussed in Memorandum 2006-33, p. 5. It is clear from the legislative history available at the State Archives that the introductory "notwithstanding clause" was intended to override governing documents that place a cap on how much an assessment may be increased in a year. So for example, a provision limiting increases to 5% per year would be overridden. Nonetheless, any increase over 20% would require member approval.

Proposed Section 5580(a)-(b) would restate Section 1366(b) to make its meaning clearer, thus:

> 5580. (a) Subject to the limitations of Section 5575 and subdivision (b), the board may increase the regular assessment by any amount that is required to fulfill its obligations and may impose a special assessment of any amount that is required to fulfill its obligations. This subdivision supersedes any contrary provision of the governing documents.
>
> (b) In the following circumstances, an assessment increase or special assessment may only be adopted with the approval of an affirmative majority of the votes cast in a member election at which at least fifty percent of the voting power is represented:
>
> …
>
> (2) The total increase in the regular assessment for the fiscal year would be more than 20 percent of the regular assessment for the preceding fiscal year.
>
> (3) The total for all special assessments imposed in the fiscal year would be more than 5 percent of the budgeted gross expenses of the association for the fiscal year in which the special assessment would be imposed.

In other words, the governing documents may not impose an absolute cap on the amount by which assessments may be increased or imposed in a year. Despite that override of the governing documents, member approval is still required if the amount of increase is greater than the specified thresholds.

The Attorney Group seems to be asserting a very different interpretation of existing law. They seem to be suggesting that the governing documents can trump the member approval requirements of Section 1366. See Exhibit p. 10. Under that interpretation, a governing document provision could state that member approval of an assessment change is never required, regardless of the size of the assessment increase or special assessment.

The staff could find no case law, legislative history, or treatise support for that reading of the statute. See, e.g., C. Sproul & K. Rosenberry, Advising California Common Interest Communities § 5.6, at 284 (Cal. Cont. Ed. Bar, 2008); J. Hanna & D. Van Atta, California Common Interest Developments: Law and Practice § 19:37 (2008). (Note that John Hanna, Curtis Sproul, and David Van Atta are signatories of the Attorney Group's letter.)

The only support offered by the Attorney Group for its interpretation of Section 1366 is the fact that some governing documents include "damage and destruction" provisions that allow for an automatic assessment, without a member vote, when necessary to reconstruct a damaged building after a major loss. That would seem to override the member approval requirements, even if the amount of the assessment change is large enough to ordinarily trigger the statutory member approval requirements.

However, there is a simpler explanation of such provisions, that does not depend on the Attorney Group's interpretation. Section 1366 already includes an exception for *emergency* assessment increases. If an increase or special assessment is required to address an emergency situation, as defined in the statute, then member approval is not required, regardless of the size of the increase or special assessment.

The emergency exception encompasses:

> [An] extraordinary expense necessary to repair or maintain the common interest development … that could not have been reasonably foreseen by the board in preparing and distributing the pro forma operating budget under Section 1365.

Thus, the existing emergency exception would seem to provide sufficient authority for the sort of "damage and destruction" replacement rule described in the Attorney Group's letter. No other special exception is required to explain the existence of such provisions.

The staff invites the Attorney Group to provide more authority for its interpretation of Section 1366(b), or to explain its position more fully if the staff has misunderstood. **Until persuaded otherwise, the staff believes that the Commission's interpretation of Section 1366 was correct and does not need to be revised.**

Diminished Remedies to Collect Assessments

The Attorney Group maintains that the proposed law places too much emphasis on the use of property to satisfy overdue assessment debt, and "diminishes" the ability of an association to hold a member personally liable for assessment debt. This concern is explained by stating that the relevant language

> is buried offhandedly and deeply in the measure, as if of little importance. It is very difficult to find. As if to underscore the point, the principle that owners are personally responsible for assessment debt is nowhere to be found in the CLRC's table showing where the elements of the Davis-Stirling have gone in the proposed new law.

See Exhibit p. 10.

The Attorney Group is mistaken. The disposition table in the Commission's recommendation correctly indicates that the source of the provision at issue (existing Section 1367.1(a)) would be continued in proposed Section 5605(d):

Existing Provision	Proposed Provision(s)
1367.1(a)	5605(d), 5615

The Commission certainly didn't intend to be dismissive of this important provision. In fact, the proposed law promotes it from a mere clause, buried in a very long section, to a separate subdivision, in a section devoted only to delinquent assessments:

> **§ 5605. Delinquency**
>
> 5605. (a) An assessment becomes delinquent 15 days after it is due, unless the declaration provides a longer time period, in which case the longer time period applies.
>
> (b) If an assessment is delinquent, the association may recover all of the following amounts:
>
> (1) The unpaid amount of the assessment.
>
> (2) The reasonable cost incurred in collecting the delinquent assessment, including a reasonable attorney's fee.
>
> (3) A late charge not exceeding 10 percent of the delinquent assessment or ten dollars ($10), whichever is greater, unless the declaration specifies a late charge in a smaller amount, in which case the late charge shall not exceed the amount specified in the declaration.
>
> (4) Interest on the delinquent assessment, the reasonable cost of collection, and the late charge. The annual interest rate shall not exceed 12 percent, commencing 30 days after the assessment

becomes due, unless the declaration specifies a lower rate of interest, in which case the lower rate of interest applies.

(c) An association is exempt from interest-rate limitations imposed by Article XV of the California Constitution, subject to the limitations of this section.

(d) The amount described in subdivision (b) becomes a debt of the member at the time the assessment or other sum is levied.

(Emphasis added.) That seemed like a natural location for the provision, grouping it with other provisions relating to the delinquency of an overdue assessment.

Does the Commission have any interest in moving proposed Section 5605(d) to somewhere more prominent?

SUBORDINATION OF SENIOR TRUST DEEDS

Existing Section 1367.1(f) provides:

> A lien created pursuant to subdivision (d) shall be prior to all other liens recorded subsequent to the notice of assessment, except that the declaration may provide for the subordination thereof to any other liens and encumbrances.

That provision is restated in proposed Section 5630(f):

> Unless the governing documents provide otherwise, a lien created pursuant to this section has priority over a subsequently recorded lien.

The Attorney Group has two concerns about this restatement. First, they believe that the power to subordinate an assessment lien should be restricted to the declaration, which is a recorded instrument. See Exhibit p. 11. The proposed law would have allowed subordination by unrecorded governing documents, such as an operating rule. Given that subordination of an assessment lien is against the interest of the association, the staff does not see what problems would result from liberalization of the process. However, if the change might cause problems, **the staff recommends that the provision be revised to replace the term "governing documents" with "declaration."** That would restore existing law on this point.

Second, the Attorney Group believes that the restated provision could be read to authorize an association to grant its liens *priority* over senior liens. See Exhibit p. 11. **The Attorney Group appears to be mistaken.** The staff does not see how

the provision could be read in that way. **The staff requests further explanation of the Attorney Group's argument on this issue.**

BOARD MEETINGS

Attorney Fees

Existing Section 1363.09 provides a judicial remedy for a violation of the Davis-Stirling Act's board meeting provisions. The section includes an attorney fee shifting provision, which provides for an award to a prevailing member, or to the association, if the member's action was frivolous.

Under the proposed law, the judicial remedy would apply to the entire article on board meetings, which would include the Davis-Stirling Act rules *plus a small number of provisions imported from the Corporations Code*. See proposed Sections 4505 (convening or adjourning a meeting), 4510 (quorum), 4515 (board action), portions of 4520 (notice of meeting), 4535 (teleconference), 4545 (action without meeting). Importation of those provisions would place all of the law governing board meetings in a single location within the Davis-Stirling Act.

The Attorney Group objects that the attorney fee provision of the judicial remedy would then apply to the provisions that are drawn from the Corporations Code, which are not currently governed by the provision. "No important public policy is advanced by simply placing these corporate principles in an Open Meeting Act and then applying one-sided attorneys' fees provisions to be applied to them." See Exhibit p. 12.

The staff disagrees. There are considerable benefits to placing all of the meeting rules in one location, where homeowners are most likely to look. In addition, the staff sees no policy justification for providing attorneys fees if a member successfully challenges a board meeting that was held without notice, but denying attorneys fees if the member challenges a board meeting that was held without a quorum. The distinction between board meeting rules that are in the Davis-Stirling Act and those that are in the Corporations Code is historical and probably does not reflect any policy choice to differentiate between them as to judicial enforcement remedies.

To the contrary, the most recent legislative policy choice was to provide a judicial remedy, with attorney fee shifting for enforcement of the Davis-Stirling Act's board meeting requirements. The staff does not believe that the Legislature would object to the same remedy being applied to the small number of fairly

minor procedural rules that would be imported into the Davis-Stirling Act from the Corporations Code.

Although the Commission's general practice has been to revert to existing law in response to any substantive objection, the staff requests that the Attorney Group provide a fuller explanation of its policy objection to uniform treatment of the enforcement of meeting requirements.

Closed Meeting Involving Member as Subject of Executive Session

The Attorney Group raises two concerns about the proposed law, with respect to a closed board meeting that involves member discipline or a member assessment dispute.

First, the group objects to letting a member choose to have such matters discussed in open session. See Exhibit p. 12. **That issue has already been addressed.** See the May 22, 2008, amendment of AB 1921, which reverses that substantive change.

Second, the group objects to language that would authorize a "a member who is the subject of the matter under consideration [to] attend and speak during consideration of the matter." See Exhibit p. 12; proposed Section 4540(d).

That provision is intended as a continuation of existing Section 1363.05(b), which provides that a member who is subject to a fine, penalty, or other form of discipline "shall be entitled to attend the executive session."

However, the existing provision should probably be tightened a bit, to make clear that the right to attend only applies when the executive session involves a member disciplinary hearing, an assessment dispute, a request for a payment plan, or a decision to foreclose on a lien. Members should not be able to attend a closed session that involves litigation in which the member and the association are adversaries, or a personnel matter if the member is an employee of the association. That would be a more faithful expression of existing law. **The staff recommends that proposed Section 4540(d) be revised to read:**

> (d) Notwithstanding Section 4525, if the board adjourns to ~~in~~ executive session, a member who is the subject of ~~the~~ a matter ~~under consideration~~ described in subdivision (b) may attend and speak during consideration of the matter.

The matters described in subdivision (b) are as follows:

(1) An assessment dispute.
(2) A request for a payment plan.

(3) A decision to foreclose on a lien.

(4) A hearing pursuant to Section 5005 (i.e., a member discipline hearing).

ELECTION RULES

Existing law requires that an association develop operating rules to address various specified aspects of member election procedure. See Section 1363.03(a). The proposed law simplified the election rule provisions, by moving provisions that actually state substantive requirements to more appropriate locations in the election statute, and then requiring generally that the election rules include any rules "required to implement this chapter" (i.e., to fill any gaps in the statutory scheme).

The Attorney Group finds this requirement puzzling and believes that it will require associations to revise their rules, thereby adding to their operating costs. The Attorney Group also maintains that the proposed law would add new content requirements for the election rules, relating to the following topics: (1) the loss or restoration of a member's voting privilege, (2) the calculation of voting power, and (3) procedures for the use of proxies, if the association permits the use of proxies. Again, the group believes this will require rule amendments, which will impose costs. The group maintains that these sorts of changes are inappropriate for a nonsubstantive bill. See Exhibit p. 13.

The proposed law was never intended to be entirely nonsubstantive. Minor improvements have been proposed throughout. The election rule provision was simplified and a few minor gaps were filled. These changes are more limited than the Attorney Group suggests: existing law *already* requires that the rules address the calculation of voting power and the use of proxies. See Civ. Code § 1363.03(a)(4).

The staff does not believe that significant rule amendments would be required as a result of the proposed changes to the election provisions. **Unless the Attorney Group is objecting to the *substance* of the proposed treatment of the operating rules, the staff recommends against making any changes.**

MEMBER HANDBOOK

The Attorney Group maintains that the proposed member handbook must contain a "discipline policy, including a schedule of penalties for violations of the

governing documents." It adds: "This proposed provision is new, substantive, and has significant fiscal implications." See Exhibit p. 13.

The Attorney Group has overlooked the recent amendment of proposed Section 4810(a), which added qualifying language to make clear that there is no new obligation to adopt an enforcement policy:

> 4810. (a) Within 120 days after the end of the fiscal year, the board shall prepare a member packet that contains all of the following information:
>
> …
>
> (6) A statement describing the association's discipline policy, *if any*, including *any* schedule of penalties for violations of the governing documents.

(Emphasis added.) That provision would not impose any new requirement on an association, other than to include its member discipline policy in the handbook, *if it has a member discipline policy*.

The Attorney Group also notes that some content requirements are not specifically referenced in Section 4810, but probably should be. That is a good point, which has already been raised by other commenters. **The staff will comb the proposed law for separate content requirements and make sure that all are specifically referenced in Section 4810.**

Finally, the Attorney Group objects to the requirement, in proposed Section 4810(b), that the association provide a copy of the member handbook to new members. They liken this to the statutory requirement that a seller provide specified information to a prospective purchaser of a CID unit, and suggest that the new provision improperly impinges on the established seller disclosure requirement. See Exhibit p. 13.

The staff does not understand the concern. The proposed law would not change the existing seller disclosure requirements. See proposed Sections 5825-5845. Nor would it require an association to provide the member handbook to a prospective purchaser, so there would be no issue of adequate disclosure of the condition of the property. The association would only be required to give a copy of the handbook *after a purchase*, to inform a new member of basic information about how the community is run. The staff sees no legal ramifications of this requirement. The only issue is a modest cost, associated with producing and delivering the handbooks. The benefit of the proposed rule is obvious.

Unless the Attorney Group can provide further explanation for its opposition to this change, the staff would recommend against making any revision of the provision.

ASSESSMENT COLLECTION REMEDY

The Attorney Group notes that existing Section 1367.4 provides that delinquent assessments that are under $1,800, or less than one year delinquent, cannot be collected through foreclosure, but can be collected in small claims court, by recordation of a lien that cannot be foreclosed until certain conditions are met, or by "any other manner provided by law."

The Attorney Group believes that the last option was not continued in the proposed law, but should have been. See Exhibit p. 14.

In fact, the provision was continued, in proposed Section 5645(a), which relates to the enforcement of a lien. The provisions at issue are properly located there, but should probably also be located in a provision dealing with delinquency generally (outside of the context of enforcing a lien). Doing so should not cause problems, because the provisions are more informational than substantive.

In the interest of clarity, the staff recommends adding language to proposed Section 5605 to parallel the language in proposed Section 5645, thus:

> **§ 5605. Delinquency**
>
> 5605. (a) An assessment becomes delinquent 15 days after it is due, unless the declaration provides a longer time period, in which case the longer time period applies.
>
> (b) If an assessment is delinquent, the association may recover all of the following amounts:
>
> (1) The unpaid amount of the assessment.
>
> (2) The reasonable cost incurred in collecting the delinquent assessment, including a reasonable attorney's fee.
>
> (3) A late charge not exceeding 10 percent of the delinquent assessment or ten dollars ($10), whichever is greater, unless the declaration specifies a late charge in a smaller amount, in which case the late charge shall not exceed the amount specified in the declaration.
>
> (4) Interest on the delinquent assessment, the reasonable cost of collection, and the late charge. The annual interest rate shall not exceed 12 percent, commencing 30 days after the assessment becomes due, unless the declaration specifies a lower rate of interest, in which case the lower rate of interest applies.

(c) An association is exempt from interest-rate limitations imposed by Article XV of the California Constitution, subject to the limitations of this section.

(d) The amount described in subdivision (b) becomes a debt of the member at the time the assessment or other sum is levied.

(e) Except as otherwise provided in this article, a delinquent assessment can be collected by any method provided by law.

(f) If the amount of the delinquent assessment is within the jurisdictional limit of the small claims division of the superior court, the association may bring an action to collect the debt in the small claims division pursuant to Chapter 5.5 (commencing with Section 116.110) of Title 1 of Part 1 of the Code of Civil Procedure. An association may enforce a judgment of the small claims division as provided in Article 8 (commencing with Section 116.810) of Chapter 5.5 of Title 1 of Part 1 of the Code of Civil Procedure. The amount recovered in an action in the small claims division, which may not exceed the jurisdictional limit of the small claims division, is the sum of the following:

(1) The amount owed as of the date of filing the complaint.

(2) In the discretion of the court, an additional amount equal to the amount owed for the period from the date the complaint is filed until satisfaction of the judgment, which may include accruing unpaid assessments and any reasonable late charges, fees and costs of collection, attorney's fees, and interest.

Comment. Subdivisions (a)-(c) of Section 5605 restate former Section 1366(e)-(f) without substantive change.

Subdivision (d) continues the first sentence of former Sections 1367(a) and 1367.1(a) without substantive change.

Subdivision (e) is consistent with the substance of former Section 1367.4(b)(3).

Subdivision (f) is consistent with the substance of former Section 1367.4(b)(1).

See also Sections 4080 ("association"), 4135 ("declaration"), 4160 ("member").

ATTORNEY GENERAL JURISDICTION

Under existing law, the Attorney General has jurisdiction to intervene in certain types of governance disputes involving a nonprofit corporation. See Corp. Code § 8216. The jurisdiction extends to enforcement of the statutory provisions governing member meetings, member elections, and record inspection. *Id.*

Proposed Section 4955 would add a similar provision to the Davis-Stirling Act. Doing so would reflect the fact that, for homeowner associations, many of the matters that used to be governed by the Corporations Code are increasingly

governed by the Davis-Stirling Act. Under the proposed law, that trend would be completed. The Davis-Stirling Act would entirely supersede the Corporations Code with respect to member meetings, member elections, and record inspection. See proposed Section 4025. Thus, proposed Section 4955 would be required in order to continue the traditional jurisdiction of the Attorney General as to homeowner associations.

The Attorney Group has two objections to proposed Section 4955: (1) The Attorney General's jurisdiction would be expanded, and (2) the Attorney Group lacks resources to meaningfully exercise its jurisdiction. Those points are discussed below.

Expansion of Jurisdiction

The Attorney Group maintains that the Attorney General's jurisdiction is limited to matters involving elections, and that proposed Section 4955 would expand the Attorney General's jurisdiction by adding record inspection. **That is incorrect.** Existing Corporations Code Section 8216 already provides the Attorney General with jurisdiction to intervene in matters involving record inspection.

However, the proposed law would add record *retention* to the list of matters that the Attorney General could address. That would expand the Attorney General's jurisdiction. The Attorney Group opposes that change. See Exhibit p. 14. Although the Attorney Group does not mention it, the proposed law would also add jurisdiction to intervene in cases where the association has not complied with annual reporting requirements. It seems likely that the group would oppose that change as well, based on its general objection to increasing the jurisdiction of the Attorney General.

Consistent with the general practice of reverting to existing law when faced with a policy objection to a substantive change, **the staff recommends that proposed Section 4955(a) be revised as follows:**

> 4955. (a) Upon receiving a complaint from a member, director, or officer that an association has violated the provisions of Article 3 (commencing with Section 4575), Article 4 (commencing with Section 4625), or Article 5 (commencing with Section 4700), ~~Article 6 (commencing with Section 4775), or Article 7 (commencing with Section 4800),~~ the Attorney General may, in the name of the people of the State of California, send a notice of the complaint to the principal office of the association (or, if there is no office, to the office or residence of the chief executive officer or secretary, of the

corporation, as set forth in the most recent statement filed pursuant to Section 8210 of the Corporations Code).

Lack of Resources to Meaningfully Exercise Jurisdiction

The Attorney Group also questions the utility of having proposed Section 4955 at all. The duties under the section would be discretionary, and given the limited resources of the Attorney General, would rarely result in more than an inquiry letter. Thus, the section would provide only "an illusion of redress." See Exhibit p. 14.

That is a reasonable criticism of the provision, but it is essentially a criticism of existing law, which has exactly the same limitations. The proposed legislation includes proposed Section 4955 on the theory that the existing Attorney General authority provides some benefits, even if they are minimal. **Should proposed Section 4955 be deleted entirely?**

RESERVE INSPECTION

Existing Section 1365.5(e) provides in part:

> (e) At least once every three years, the board of directors shall cause to be conducted a reasonably competent and diligent visual inspection of the accessible areas of the major components that the association is obligated to repair, replace, restore, or maintain as part of a study of the reserve account requirements of the common interest development, *if the current replacement value of the major components is equal to or greater than one-half of the gross budget of the association, excluding the association's reserve account for that period.*

(Emphasis added.) That provision would be continued in proposed Section 5550, *without the italicized exception*.

The Attorney Group objects to removal of the exception. See Exhibit p. 14.

The purpose of the exception is unclear. The Attorney Group seems to be suggesting that the exception allows associations with small replacement obligations to avoid inspecting the major components.

The staff has two concerns about that approach. First, it is not clear why an association with a small replacement obligation should be exempt. The burden on directors imposed by this duty should be proportional to the magnitude of the replacement obligation. In an association with a small replacement obligation, the burden of inspection should also be small, because there will not be many major components that need to be inspected. Given that the burden of

inspection scales in that way, is there a need for a de minimus exception? Is it good policy for the major components of a small association to go uninspected?

Second, it does not make sense to establish a de minimis rule by reference to the *ratio* of the replacement obligation and the operating budget. The size of the association may have nothing to do with that ratio. Consider two examples: A small association has a very modest replacement obligation ($6,000), and an equally small annual operating budget ($10,000 per year). The existing exemption would not apply to that association, despite its small size. By contrast, a larger association has a replacement obligation of $1 million. But it has an annual operating budget of $2.5 million (it has extensive landscape maintenance costs and operates a golf course for its members). The exemption would apply to that association. In the staff's view, the existing rule does not produce a coherent policy result.

The staff invites the Attorney Group to explain how the exemption is intended to operate and why. Perhaps it can be adjusted to better conform to some clear policy goal.

RESERVE FUNDING AND "PROJECTED INCOME"

The Attorney Group correctly points out that proposed Section 5555(c) should not include a reference to "projected income" in describing the projected balance for the association's reserve fund (in the reserve funding study). See Exhibit pp. 14-15. **The provision should be revised to delete that language.**

DISTRIBUTION OF MEMBER EMAIL ADDRESSES

The Attorney Group objects to proposed Section 4700(a)(2), which would allow a member who requests the association's membership list to receive any email address that the members provided to the association as contact information. See Exhibit p. 15.

That would be a substantive change. In light of the default approach of reverting to existing law in response to a policy objection to a substantive change, **the staff recommends that proposed Section 4700(a)(2) and its Comment be revised as follows:**

> (2) The membership list, including member names, property addresses, and mailing addresses~~, and electronic mail addresses~~.

Comment. Subdivision (a) of Section 4700 continues former Section 1365.2(a) without substantive change, except for the following changes:

Subdivision (a)(1) is new.

~~Subdivision (a)(2) includes an electronic mail address in the information that must be provided as part of the membership list.~~ The substantive limitations on use of a membership list are not included in this section. They are continued in Sections 4715 and 4725.

…

BURDEN OF PROOF IN JUDICIAL PROCEEDING TO COMPEL RELEASE OF RECORDS

The Attorney Group maintains that proposed Section 4735(e) would "shift" the burden of proof in a judicial proceeding to compel release of records, by providing that the association "bears the burden of proving the legal grounds for noncompliance with [a] records request." See Exhibit p. 15.

That is an overstatement. Although proposed Section 4735(e) is broader in application, it tracks the policy of existing Section 1365.2(a)(1)(I)(ii), which places the burden of proof on the association in a judicial proceeding to compel the production of the membership list:

> If the request is denied, in any subsequent action brought by the member under subdivision (f), the association shall have the burden to prove that the member would have allowed use of the information for purposes unrelated to his or her interest as a member.

The Commission should consider narrowing proposed Section 4735(e), to restrict it to the scope of the existing rule, as follows:

(e) ~~The~~ In an action to enforce a request for the membership list, the association bears the burden of proving the legal grounds for noncompliance with the records request.

Comment. …

Subdivision (e) is comparable to former Section 1365.2(a)(1)(I)(ii) and Corporations Code Sections 8331(f)(1) and 8332~~, except that it applies to all records and not just to a membership list~~.

LIABILITY FOR FAILURE TO REDACT

Existing Section 1365.2(d)(1) provides that an association "may" redact certain specified information when providing records for inspection by a

member. Subdivision (d)(3) of that section expressly provides that an "officer, director, employee, agent or volunteer of an association" can be held personally liable "for damages to a member of the association or any third party as the result of identity theft or other breach of privacy" as a result of a "negligent" failure to redact.

Because of that risk of liability, the Commission proposed that the duty to redact be made mandatory, in order to alert homeowners of the necessity of redaction. See proposed Section 4710. A note following that provision in the tentative recommendation specifically requested public input on the change. The comments received in response uniformly supported the change. That included comment from the California Association of Realtors and from the Attorney Group signatory Curtis Sproul, who is also co-chair of the CID Subsection of the Real Property Section of the State Bar, who wrote as an individual: "the addition is a great idea. We support making the redaction requirements mandatory." See Memorandum 2007-47, Exhibit pp. 185, 250.

Nonetheless, the Attorney Group opposes the change. They are concerned that a mandatory statutory duty would create grounds for an argument of negligence per se when a volunteer fails to redact a record.

Consistent with the default approach of reversing a substantive change in response to a policy objection, the staff recommends that proposed Section 4710 be revised to restore the non-mandatory language of existing law:

> 4710. (a) Before making a record available for inspection, the association ~~shall~~ may redact all of the following information from the record:
>
> (1) Any financial account number.
>
> (2) Any password or personal identification number.
>
> (3) Any social security number or taxpayer identification number.
>
> (4) Any driver's license number.
>
> (5) Any other information, if it is reasonably probable that disclosure of the information will compromise the privacy of a member, lead to unauthorized use of a person's identity or financial resources, or is reasonably likely to lead to fraud in connection with the association.
>
> (b) Before providing a membership list, the association shall remove the name and other information of any person who has opted to have that information removed from the membership list pursuant to Section 4715.
>
> (c) If the member requests, the association shall provide a written statement explaining the legal justification for any redaction made.

Comment. Section 4710(a) restates former Section 1365.2(d)(1)~~, except that the duty to redact certain information has been made mandatory~~.

…

SMALL CLAIMS JURISDICTION AND EQUITABLE RELIEF

Proposed Section 4735 would provide a judicial remedy for a member whose record request is denied. It is drawn in large part from existing Section 1363.09. Consistent with that section, it would permit an action to be filed in the small claims division of the superior court, but only if the amount of the demand does not exceed the jurisdiction of that division.

The new section would also incorporate some other forms of relief that are available in similar proceedings under the Corporations Code. Thus, in addition to compelling production of records, the court could provide the following relief:

> (d) The court may grant any other relief appropriate to the circumstances, including the following relief:
>
> (1) If the association acted unreasonably in denying the request, the imposition of a civil penalty of up to $500 against the association.
>
> (2) The tolling of any deadline affected by association delay in providing access to a record.
>
> (3) The postponement of a scheduled board meeting or member meeting, if association delay in providing access to a record would prejudice the requesting member's interest in a decision to be made at the meeting.
>
> (4) The appointment of an investigator or accountant to inspect or audit association records on behalf of the requesting member. The cost of investigation shall ordinarily be borne by the requesting member, but the court may order that the association bear or share the cost. This paragraph applies only to an association that is a corporation.
>
> (5) An order requiring that the association distribute material to the membership on behalf of the requesting member, in lieu of disclosing the membership list.

The Attorney Group has objected to a small claims court having jurisdiction to grant the relief described in paragraphs (2)-(4). See Exhibit p. 16.

Paragraphs (3) and (4) are derived from Corporations Code Sections 8335 and 8336, which govern similar judicial proceedings involving record requests under that code. Paragraph (2) would be new, but it is a logical extension of the principle expressed in paragraph (3). The point is that an association should not

be able to make a member miss a procedural deadline by delaying production of the membership list or any other requested record.

However, the staff agrees that relief of this type would not ordinarily be within the jurisdiction of the small claims division. **For that reason, proposed Section 4735 should be revised to make clear that the relief stated in paragraphs (2)-(4) cannot be granted by the small claims division. The revised section would read as follows:**

> (d) The court may also grant the following relief:
> (1) If the association acted unreasonably in denying the request, the imposition of a civil penalty of up to $500 against the association.
> (2) An order requiring that the association distribute material to the membership on behalf of the requesting member, in lieu of disclosing the membership list.
> (e) In an action that is not filed in the small claims division, the court may grant any other appropriate relief, including the following:
> (1) The tolling of any deadline affected by association delay in providing access to a record.
> (2) The postponement of a scheduled board meeting or member meeting, if association delay in providing access to a record would prejudice the requesting member's interest in a decision to be made at the meeting.
> (3) The appointment of an investigator or accountant to inspect or audit association records on behalf of the requesting member. The cost of investigation shall ordinarily be borne by the requesting member, but the court may order that the association bear or share the cost. This paragraph applies only to an association that is a corporation.

Subdivisions following that language would be renumbered as appropriate.

MISSED OPPORTUNITIES

The Attorney Group urges the Commission to make some additional improvements to existing law that were not included in the proposed law. See Exhibit pp. 16-17. If these points had been raised during the Commission's study, the Commission would have considered whether to address them. In many instances, the Commission refrained from making suggested improvements, because the issues were substantial or complex and it seemed better to deal with them in a separate reform, rather than complicating the overall rewrite of the Davis-Stirling Act.

The Attorney Group's suggestions are as follows:

- Maintenance responsibilities should be further clarified. See Exhibit p. 16. This suggestion is too general to act on. **The staff requests that the Attorney Group explain this suggestion and indicate what changes it would like to see.**
- Existing references to the mutual benefit corporation law should be broadened to include public benefit corporations. *Id.* **The staff will review this suggestion and report back in a later memorandum.**
- Section 1376 is almost entirely preempted by FCC regulations and should be adjusted to reflect that fact. *Id.* **The staff requests that the Attorney Group explain this suggestion further and indicate what changes it would like to see.**

The Attorney Group also maintains that its concern about the definition of "exclusive use common area," which was raised in its prior letter, has not been properly addressed. See Exhibit p. 17. In broad brush, the concern was that changes to the phrasing of the definition had changed its meaning in problematic ways. In response to that concern, *the definition was amended to restore the existing language*. **The staff does not understand why that change would not have addressed the group's concern.** We would appreciate further explanation.

MISCELLANEOUS ISSUES

The Attorney Group's letter concludes with a list of other miscellaneous issues that have been "spotted so far," but that are not explained. See Exhibit pp. 17-18. The group indicates that the issues vary in seriousness, but that all will need to be addressed. *Id.* at 17.

These issues are not described with enough specificity for the staff to understand them and respond. **The staff requests that the Attorney Group provide an explanation of the basis for the concerns and any proposed resolution.** In doing so, the Attorney Group should review the most recently amended version of AB 1921, to make sure that the concern has not already been addressed. (For example, it appears that concerns about meeting locations were addressed by the amendment deleting proposed Sections 4530 and 4575(c).)

CONCLUSION

Because of the large number of changes that have been requested by interest groups during the legislative process, the staff recommends that the

Commission's recommendation on this matter be withdrawn (it has not yet been printed), and revised to conform to the revised language. The legislative process will be simpler if the Commission's report conforms more closely to the language that will actually be in the implementing legislation.

In doing so, the staff would rewrite the preliminary part and would comprehensively review the Comments, to make sure that they correctly reflect the effect of the revised draft.

The staff also recommends that the revised draft be circulated as a revised tentative recommendation, specifically soliciting review and comment from the Attorney Group, the CID Subsection of the Real Property Section of the State Bar, and all other interested groups and individuals. Doing so would delay introduction of implementing legislation, but that seems justified, for several reasons:

(1) There is no *urgent* need for enactment of the proposed legislation.
(2) Review of the Attorney Group's comments on AB 1921 will be time consuming, and may not be completed before the end of this year. Pending legislative assignments to the Commission will need to take priority and may significantly slow our work on this study.
(3) An extension of additional time will increase the chance that the reviewing groups will be able to find any problems that need to be fixed, ensuring a better proposal.
(4) An extension of time will defuse any complaints that the Commission hurried the project and did not solicit the input of experts. Although the staff takes exception to those objections, they have been made, widely and forcefully. An extension of time would make such complaints untenable.

The staff would only recommend this approach if the Attorney Group is willing to make a commitment to work with the Commission during the extended time period, in order to improve the proposed law.

Respectfully submitted,

Brian Hebert
Executive Secretary

June 10, 2008

Senate Judiciary Committee
Gene Wong, Chief Counsel
State Capitol
Room 2187
Sacramento, CA 95814

Senate Transportation & Housing Committee
Carrie Cornwell, Chief Consultant
State Capitol
Room 2209
Sacramento, CA 95814

Re: AB 1921 (Saldana)

Dear Committee Members and Mr. Wong and Ms. Cornwell:

We are 25 attorneys from throughout California who remain very concerned about the alarming pace with which AB 1921 (Saldana) - a major bill to rewrite the state's regulatory laws for common interest developments - is being considered in the Legislature.

The lack of awareness and meaningful debate on significant policy changes that have been inserted into this measure - whether unwittingly or intentionally - should trouble every legislator who considers voting to pass this bill forward. The number of undisclosed substantive changes is simply alarming. The proposed new law's outline is unorthodox, disorganized, and ultimately unhelpful to a law that is supposed to be easy to read. The sheer length and density of this bill is unnecessary and make it frustrating for anyone to understand and use.

The proposed law was drafted by the California Law Revision Commission and its staff, without requiring the use of experienced legal consultants or obtaining a thorough legal review. As grave flaws in this legislation come to light – in organization and substance - it is regrettably apparent that the CLRC lacked the resources, experience and practical knowledge that were needed to confidently rewrite this law. The fact that the CLRC is now wholly resistant to requests for a measured review, when there is no urgency to adopt a totally revised law without it, is extremely troubling.

The proposed law is seriously flawed in ways that, if approved, will create confusion and enormous cost, both of which will last for years and reflect poorly on the reputation of the CLRC and the Legislature. As drafted, the CLRC's recommendation cannot be approved without these consequences.

In every instance in which this bill was discussed by the California Law Revision Commission, its memoranda and comments reiterate that the purpose of this measure was solely to "reorganize, simplify and clarify" the law. None of these goals has been met, and the opposite can in fact be said. Badly off its aim and despite the limited billing it gave its effort, the CLRC felt compelled to break apart and reword virtually every provision of the Davis-Stirling

Common Interest Development Act (Civil Code § 1350 et seq.) .[1] Passages that have nothing wrong with them, that have stood the test of time, that are cited in published cases, and that today resound in thousands of existing governing documents are now paraphrased, missing, moved, broken up, or devoid of context. The meaning and effect of existing law are jeopardized over and over again without apparent benefit.

The law is *not* made clearer or simpler. Our analysis shows that this restatement is complicated, labyrinthine in places, marred by hundreds of cross-references, and full of unintended results. Provisions that should have been clarified are not. Despite its limited goals, the CLRC chose to add new concepts, create new burdens and liabilities for associations and their directors, insert new impediments that are unfriendly to the operations of community associations as businesses, and did not evaluate the cost.

We have been criticized for not staying closer to the CLRC's processes. Right or wrong, we trusted the CLRC to do only what it said. Had we been asked, we would also have trusted that when a complete restatement of *any* law is actually planned, a Commission whose singular charge is to revise law would *require* the use of legal consultants who practice in the field. We would trust that it would not simply rely on whatever comments were volunteered, and also that the CLRC should have known that the limited response it received from legal professionals in our field was not an adequate vetting of the deep changes that were afoot.

This bill affects the lives and livelihoods of millions of Californians. We urge the Legislature to consider AB 1921 with far more care, to ask hard questions, to learn more about its implications, effects and costs, and to insist on well-conceived, well-organized and well-written law. Because AB 1921 fails that standard, we urge the Legislature to require further study and comment and to defer consideration of this complex bill until the 2008-2009 legislative session.

The CLRC plays an important role in helping to keep California law fresh and on the leading edge. However, we believe the Legislature has to be very hesitant to accept recommendations of the Commission when it knows they were not fully and deeply reviewed by working attorneys in whatever field is being studied.

SERIOUS CONCERNS

In our April 18, 2008 letter to Assembly Member Lori Saldana and the CLRC, we provided several egregious examples of legal problems with the CLRC bill. The author since then asked us to provide more examples of our concerns. In responding, our group has submitted many comments about key problems with the Commission's methods and drafting decisions, major changes in policy, and significant substantive problems. As we look more and more deeply and also fail to find what we would otherwise expect, we know the following is nowhere near exhaustive.

[1] All further references to sections of law are to the Civil Code, unless stated otherwise.

CLRC Methods and Drafting Decisions

The CLRC chose an unconventional and non-intuitive organizational approach for the new law. This significantly impedes comprehension and ease-of-use. It took 87 sections of concise law, broke them up and spread them out over nearly 3,000 sections. This makes it difficult to locate everything relevant to a subject. It paraphrased almost every section of existing law, changing and editing without restraint, justification or apparent consideration of the consequences. It elected to incorporate some provisions in the Corporations Code, but did so incompletely. It did not stop, look and reconsider when its idea of incorporating statutes grew far too complex. A separate body of law must still be consulted, but now in far more complex ways. By breaking up the law as it did, it was then forced to stud the new law with interminable cross-references that quickly frustrate and cause the reader to lose continuity and understanding.

The Proposed Act is Disorganized

Whether drafting legislation or lengthy governing documents, there are basic rules of organization for how to put together concepts, words, and phrases in logical order. The CLRC bill has no recognizable outline for a law involving complex real property interests.[2] Rather than build on an organizational style that is familiar to most people involved with CIDs, the CLRC threw out the basic organization of the original Act. The result is disorganized and frustrating.

When the current law was proposed in 1985, it had a straightforward, recognizable organizational style. The drafters of the Act respected the fact that developers would be creating thousands of new developments that would come within its ambit and would be crafting thousands of governing documents that needed to apply the Act's provisions correctly. And since the Act was to be applied retroactively to many existing developments, a clean organizational outline of the Act was necessary to help determine which developments would then be regulated by its provisions.

To these ends, the Act began with basic definitions and immediately followed with the basic legal requirements for creating common interest developments and for determining when and if the Act applied. The overarching topic of governing documents came next - fundamental, since governing documents contain the real property legal principles to be applied to developments with common area and they establish the basic legal authority of associations. Provisions for ownership interests, restrictions on partition, and easement principles (essential, because some form of common area must always exist in a CID) followed.

The Act then turned to operational and governance matters, how operations are funded, how assessments are imposed and collected, how property rights are transferred, how CC&Rs are enforced and disputes resolved, provisions assuring legal standing to associations and that

[2] We see echoes of the approach in the Probate Code, also a CLRC product. However, the Probate Code spans four volumes and has never to our knowledge been urged on the general reading public. The Davis-Stirling Act is a far smaller body of law with a distinct purpose and requires far different organizational treatment.

describe the basic legal rights of all involved. Last came an assortment of miscellaneous provisions.

This organization makes eminent sense. And it is not just the Davis-Stirling Act that is organizationally sensible. If one also looks at the Uniform Acts, such as the Uniform Condominium Act or the Uniform Common Interest Ownership Act (UCIOA), it is clear that the drafters of those laws understood how such an act should be structured. UCIOA is built upon the following outline:

- Short Title
- Definitions
- General Terms
- Application
- Creation / Architectural Control / Termination
- Operational Issues
- Enforcement

As an act to regulate common interest communities, UCIOA appropriately addresses *real property principles* before it delves into membership issues of governance or operations. So too did the original Davis-Stirling Act. In the proposed new Act, however, corporate or operational issues of *associations* predominate over the protection of property interests in *common interest developments*. Chronologically and organizationally, this is out of order.

Principles based on the development and ownership of real property are not where they properly should be. Essential principles that define the creation of CIDs are shunted to the back of the Act where finding them becomes serendipitous. The risks inherent in the CLRC's decision to do this are described in more detail below but, beyond that, we understand that the CLRC may actively be considering including even *more* types of real property developments under the aegis of the Act. Poor organizational choices bode badly for that effort, as analyses regarding potential newcomers would be difficult. In analyzing whether the Act newly applies or not to a particular community, serious and costly mistakes can and will be made, in large part because of the poor positioning of key concepts in a massive bill. This fundamental problem is hardly illustrative of a simpler or clearer law.

Attorneys who advise developers consult the Act in creating legal structures for CIDs that reflect the vision of their developers, the requirements of the Subdivision Map Act, and the consumer-protective disclosures of the Subdivided Lands Law. They use the Act to develop legal documents that properly capture diverse property interests. This is difficult and precise work. Their concerns are less about the ongoing operations of existing communities and more about their origination and creation - each a unique real property development incorporating common area. Definitions in the Act are critical, as are provisions that explain how and when the Act applies to specific property and how and when it does not. How the Act is organized is of essential importance to attorneys applying its terms.

Rather than follow the current law's organization or the other recognized outlines for common interest communities described above, the first 70 sections of the CLRC's proposed new law are a jumble of disassociated terms and concepts (under the rubric of "general

provisions"), ranging from discussions of nonresidential developments, to references to zoning, to quorums of association members, to how notice gets delivered.

Among these sections is the key one that is supposed to incorporate the Corporations Code into the new Act. It is largely incomprehensible and will form the foundation for an untold amount of misunderstanding and dispute. Proposed new Section 4025 reads:

> 4025. (a) Except as otherwise provided, an association that is incorporated is governed by this part and by the Corporations Code.
> (b) The following provisions of the Corporations Code do not apply to an association, unless a provision of this part expressly provides otherwise:
> (1) Sections 5211 and 7211.
> (2) Chapter 5 (commencing with Section 5510) of Part 2 of, and Chapter 5 (commencing with Section 7510) of Part 3 of, Division 2.
> (3) Sections 5610, 5611, 5612, 5615, 5617, 7610, 7611, 7612, 7614, and 7616.
> (4) Chapter 13 (commencing with Section 6310) of Part 2 of, and Chapter 13 (commencing with Section 8310) of Part 3 of, Division 2.
> (c) An association that is not incorporated is governed by this part and by any provision of the Corporations Code that is applicable pursuant to this part.

To understand what all this means, a reader must (1) know what "this part" means, (2) know whether his or her association is incorporated, (3) have the Corporations Code available to consult, (4) be experienced enough to know what the references to "chapters," "parts" and "divisions" mean, (5) locate and consult these laws correctly, (6) remember which references do *not* apply to the Act and analyze what that means, (7) spot and analyze the import of often-ignored phrases such as "except as otherwise provided" and "unless a provision of this part expressly provides otherwise," and (8) be familiar enough with the rest of the Act to know what the overall effect is supposed to be with respect to the issue being researched.

How will an owner, board member or manager be able to do this? Having been told that the proposed new Act is "simpler" and "clearer" and easily able to be understood, what they will really find is a law that exhausts, frustrates, and infuriates. There will be significant cost incurred to obtain legal analysis and explanation.

It appears to be the view of the CLRC that the operations and governance of associations should dominate the Act. In re-organizing the new Act around this very questionable premise, it has allowed fundamental real property principles to be de-emphasized, disconnected, and pushed back in the Act. In breaking up and relocating these principles, they are now difficult to find and comprehend. The proposed new Act has been restructured in so unconventional a way that it starts out *without* definitions or a discussion of what property the Act actually applies to and examines hundreds of subjects before it addresses the basic issues of what a common interest development is and what it takes to form one. It seems just basic statutory drafting structure to not go off into details and minutia before stating the legal premise of what is being formed and covered.

With respect to the ineffective effort to import provisions of the Corporations Code into the Act, as drafters we have all experienced that moment when we must accept, despite every effort, that an approach we've tried just doesn't work. In this case, the CLRC came to and passed that moment, continuing on in its efforts to incorporate portions of the Corporations Code until they became impossibly unwieldy. If the new Act is implemented without significant restructuring, a basic analysis of which corporate principles apply and which do not will be complicated and costly. The Corporations Code still needs to be at hand (indeed, even *more* so than before), so no advantage there has been gained in the failed incorporation process.

The CLRC should have eventually acknowledged that the simplicity of current Section 1363(c) – a single cross-reference incorporating the applicable Nonprofit Corporation Law - is ultimately a far sounder approach. Thousands of associations could continue to rely on their bylaws, simply updating them from time to time. Conversely, making radical, incomplete and obscure changes in the law will make most bylaws instantly obsolete and will require associations to hire attorneys to figure out answers to questions no one currently needs to ask.

The simplest and clearest solution to the incorporation question is to not do anything. If the current corporate scheme in the Act isn't retained, the Legislature must expect significant increases in the legal budgets of associations. This translates to assessment increases that would not otherwise be necessary.

Two Examples

The results of the CLRC's choice of outline are unsettling in many ways, but the following examples trouble us greatly as attorneys practicing in this field.

Lost Bearings

The *current* Act begins with Section 1350, identifying the name of the Act. Leaving aside a few recent misplaced insertions, definitions immediately follow, including one that defines a common interest development as one of four types of developments or projects. Each of these four types is also defined.

Section 1352, which immediately follows the definitions, contains essential information about the creation of a CID. Specifically, the Act applies and a common interest development is created when title to a separate interest is coupled with an interest in common area or membership in an association, upon the recording of specified documents, and when the first separate interest is conveyed. *No common interest development is created until <u>each</u> of these events occurs.*

In the proposed new Act, the CLRC first presents the scramble of preliminary provisions and attendant problems described above. When the definitions are *finally* reached at Section 4075, the term "common interest development" has a new meaning. It includes *part* of current Section 1352 (i.e., a separate interest coupled with an undivided interest in common area or membership in the association) and states that the four types of developments or projects are *included* in the term (but apparently not exclusively). After the definitions, however, the outline immediately veers into association and corporate matters, and doesn't return to the subject of

the actual creation of a common interest development and the application of the Act until almost 2,000 section numbers later.

The impression left, of course, is that a "planned development" or "condominium project," for example, (and for that matter, a "common interest development" as that term is re-defined) simply exists when and if it satisfies its definition, ***not*** when the events currently specified in Section 1352 (and not available in the restatement until *Section 6000*) occur. The problem with this disorganization of concepts is that it is entirely possible that a planned development or condominium project could be thought to exist because it satisfies a CLRC definition, but yet not *be* a common interest development at all.

Burying in the back of the Act such essential real property principles as recording a declaration of covenants, conditions and restrictions and conveying a first separate interest, in favor of immediately discussing a member bill of rights or association governance, shows a frustrating lack of understanding of what this law is all about and how it is used.

Displaced Emphasis - Governing Documents

Another major problem with the re-organization of the new Act lies in the displacement of the pivotal subject of "governing documents." Not only do governing documents drive the proper creation of common interest developments, governing documents are the primary "local" resource that guides owners, boards and managers. Discussion of governing documents is found front and center in the current Act, where it rightfully belongs, while the proposed new Act de-emphasizes and relegates governing documents far to the back. As *primary* sources of authority for the creation and operation of common interest developments (not the least of which are sections devoted to operating rules and regularly used), these sections of law should be far more accessible to directors, managers and members. This obscuring treatment should be unacceptable and, again, will encourage mistakes and misunderstandings.

Massive Expansion of the Act

For all its flaws, the current Act is a compact body of law. The CLRC bill breaks up current sections of law, moves subdivisions out of their context, redefines essential terms, inserts hundreds of cross-references (each of which have to be explored for any competent analysis), *and* then paraphrases the pieces. Not only are the pieces placed where they can't logically be found, the proposed law takes 87 statutes and spreads them out over nearly 3,000 section numbers. The proposed new law is internally complicated and far too large.

The current Act can be read in a few hours, after which readers can claim to be reasonably acquainted with what's in it. We agree the separate Corporations Code can be somewhat difficult, but in practice most provisions that apply on a day-to-day basis in an association can be found compiled in its bylaws.

The proposed new Act might (possibly) be read in days but not with much comprehension. The sheer volume of pages, sections, words, definitions, exceptions, exclusions, exemptions, inclusions, general terms, and cross-references simply defeat understanding.

Most people's understanding of what the CLRC set out to achieve was to break up and re-organize a few longish and overgrown statutes. No one argues that the basic outline of the Act has grown fuzzy over time, with amendments stuck in unexpected places. We expected that provisions like these would be re-organized, but also that the original organizational style of Davis-Stirling would be retained, as would the clear advantage of current familiarity with the Act. What has happened instead was unexpected. What was billed as merely clean up or stylistic changes has gone far beyond, and in the process does not provide Californians with any valuable service.

Examples of Significant Policy Changes

Whether intended or simply unschooled, the following many examples show a proposed new law that contains significant changes in public policy for CIDs.

Mandatory full-funding of reserves

California law currently requires an association to disclose to owners and prospective purchasers whether and to what degree its reserves are funded, but it does not require an association to have fully-funded reserves on hand. Regardless of whether we agree this is sound public policy, the CLRC bill would require associations to fully fund reserves as of 2010. There has been *no public debate* about a concept that could cost homeowners billions of dollars.

Proposed Section 5575(a) would *unconditionally* provide that an "association shall levy regular and special assessments sufficient to perform its obligations under the governing documents and this title." Current law contains the same mandate, but the requirement is subject to statutory limitations on, among other things, the board's ability to increase assessments and impose special assessments. As seen in other places in the CLRC bill, important modifers in existing law have been dropped. In this case, the critical limiting phrase in existing Section 1366(a) - "*Except as provided in this section"* - is not retained. Instead, there is only the mandate to both boards and members to assess and be assessed.

Section 5580(a) refers back to and relies on limitations in Section 5575. As we've noted, however, there *are* no limits placed on the mandatory funding rule stated in Section 5575(a). It then refers to remaining limitations in Section 5580, but these are limits on boards of directors only.

This momentous policy change is underscored (1) in the statutory form "Summary of Reserve Funding Study" (Section 5555) which refers to "total *required* balances" (without definition in the form) and (2) in the reserve funding plan (Section 5560) which requires every association to state in non-discretionary terms "how the association *will contribute sufficient funds to the reserve account*." (emphasis added.) If it approves AB 1921 without further study, the Legislature will create a statutory obligation to fund "sufficiently," where it heretofore has scrupulously avoided dictating how and when reserves will be funded. Associations can be and are sued when owners mistakenly blame their associations for not putting aside enough funds. AB 1921 creates a full-funding scheme and invites serious litigation under the statute.

Policy Impediments to Assessment Increases

Current law has for twenty years given boards of directors an essential tool to acquire the funds needed to operate community associations. Boards may increase regular assessments up to 20% over the prior year's assessments without member approval, with one condition - they must distribute a conforming operating budget, with a reserve study summary, to members within a specified statutory period before the beginning of the next fiscal year. If the budget is not timely prepared and distributed, regular assessment increases must be approved by members.

The CLRC would place several new conditions in the way of regular assessment increases. New Section 5580 would require compliance with all of new Section 4800's "annual budget report" before regular assessments could be increased. The "annual budget report" would include the traditional operating budget, but would now also include the following *three* additional requirements: (1) a statement of estimated revenue and expenses for the *reserve* account for the upcoming year (as opposed to "a summary of the association's reserves" in current Section 1365), (2) the *full* reserve funding study required in new Section 5555 (as opposed to the aforementioned "summary of the association's reserves"), i.e., not just Section 5555's form summary of the funding study (this form is an enhanced version of current Section 1356.2.5's statutory form, distribution of which is *not* a prerequisite to regular assessment increases), ***and*** (3) an insurance disclosure that, under current Section 1365, is distributed during the same statutory period as the budget but is *not* part of the budget and *has never been* a prerequisite to approving a regular assessment increase.

The CLRC does not disclose these added obstacles to protecting an association's assessment stream, available in the law for two decades, or any policy basis for proposing such conditions at a time when assessments are a victim of the subprime mortgage market and have never been more threatened.

Policy Impediments to Limited Special Assessments

Proposed Section 5580 would introduce a completely new policy impediment to a board's authority to raise revenue to meet its obligations under the law. Boards have the power under current Section 1366 to levy special assessments of up to 5% of that year's budgeted gross expenses without a member vote. There are no prerequisites or tests that must first be met.

New Section 5580 would lump regular assessment increases *and* 5% special assessments under the same scheme. For the first time California law would prohibit a board from levying a 5% special assessment if it did not first satisfy all prerequisites (old and new) for *regular* assessment increases noted above. Legal changes that attack the ability of boards of directors to operate associations in a fiscally sound and financially businesslike manner should be rejected.

Policy Override of More Liberal Assessment Provisions in Governing Documents

New Section 5580's provisions regarding assessments state that they "[supersede] any *contrary* provision of the governing documents." Current law provides that Section 1366 prevails "notwithstanding *more restrictive* provisions in the governing documents." (emphasis added.) This new change ignores the fact that CC&Rs may currently contain more liberal assessment provisions, approved by the owners. This principle is seen most often (although certainly not exclusively) in so-called "damage and destruction" provisions, where reconstructing a damaged building after a major loss is mandatory, as are the assessments, if needed, to pay for it. We are unaware of any policy basis for such a dramatic change, certainly not in a measure billed merely as "clarification." Because it has paraphrased the law where it does not need changing, the CLRC has proposed a new principle that would override long-standing, beneficial CC&R provisions. Such provisions are designed to promote certainty, they identify important risk-sharing principles among co-owners of property, and they are good public policy.

The CLRC's comment on new Section 5580(a) states that "[s]ubdivision (a) makes clear that a board's authority to impose an assessment increase that is required to fulfill its legal obligations may not be limited by the governing documents." The Commission is incorrect: subdivision (a) does exactly the opposite, both by overriding more liberal provisions in the governing documents that are intended to help a board "fulfill its legal obligations" and by cross-referencing/incorporating subdivision (b) which is the essence of limitations.

Diminished Remedies to Collect Assessments

The CLRC bill places significant emphasis on the obligation of *property* to pay assessments, i.e., there is much about liens and their enforcement. However, associations have a dual remedy to enforce the payment of assessments, in that they may also collect from *property owners*, each of whom has a personal obligation to pay assessments.

Current Section 1367.1, in its opening subdivision, clearly emphasizes the dual nature of an association's remedies:

> A regular or special assessment and any late charges, reasonable fees and costs of collection, reasonable attorney's fees, if any, and interest, if any, as determined in accordance with Section 1366, shall be *a debt of the owner of the separate interest* at the time the assessment or other sums are levied. (emphasis added.)

In the CLRC bill, however, this principle that is so crucial to associations is buried offhandedly and deeply in the measure, as if of little importance. It is very difficult to find. As if to underscore this point, the principle that owners are personally responsible for assessment debt is nowhere to be found in the CLRC's table showing where the elements of Davis-Stirling have gone in the proposed new law.

Subordination of Senior Trust Deeds, By Rule

Current Section 1367.1(f) provides that "[a] lien created pursuant to subdivision (d) shall be prior to all other liens recorded subsequent to the notice of assessment, except that the declaration may provide for the subordination thereof to any other liens and encumbrances."

Proposed Section 5630(f) would instead provide that "[u]nless the governing documents provide otherwise, a lien created pursuant to this section has priority over a subsequently recorded lien."

There is nothing wrong with the current language, and a *huge* difference is made by paraphrasing. The concept goes from emphasizing that an assessment lien can be made subordinate, to emphasizing that a lien can have priority. Current law allows an association's lien to be made subordinate in the recorded CC&Rs to later recorded liens. However, the proposed language would flip subordination on its ear and, by changing the words, can be read to mean that what can be "provided otherwise" is priority of assessment liens over even *prior* recorded liens. And since "governing documents" include unrecorded rules, the uproar from lenders if this language ever becomes law will be deafening.

There was no need to change this provision in the first place, an example of a wholly unnecessary change having big results. The existing language - that "the declaration may provide for the subordination" of assessment liens - is very specific and clear. And by intentionally substituting the term "governing documents" for the word "declaration," the new Act would immediately and unnecessarily broaden the provision's application (true *anywhere* in the CLRC bill where these words may have been switched). Yet the CLRC comment actually states that proposed Section 5630(f) merely restates existing law without substantive change.

CID Open Meeting Act (§ 1363.05)
Attorneys' Fees Provision Applied to NonProfit Corporation Laws

The current CID Open Meeting Act is concise - 10 subdivisions focused exclusively on the nature of and procedures for open meetings and executive sessions of the board. The *new* CID Open Meeting Act breaks apart these 10 subdivisions and paraphrases them in places, every one a problem in its own right. The CLRC then imports provisions of the Corporations Code into the new Open Meeting Act that have *nothing* to do with membership interests in whether meetings are open or closed. As an organizational approach, this is confusing and misleading.

The new CID Open Meeting Act would then make awards of attorneys' fees available in disputes over the imported board meeting sections of the Corporations Code. Such awards have never existed before for these sections of the law. This is an indirect and unprecedented application of attorneys' fees to the Nonprofit Corporation Law, without disclosure or debate.

Several years ago when the CLRC was studying CID enforcement issues and moved pre-filing ADR out of Section 1354, it proposed that ADR requirements apply not just to governing document disputes but also to enforcement of the Davis-Stirling Act and the Nonprofit

Corporation Law. It recognized the issue of applying attorneys' fees provisions in these later two contexts and drafted carefully (see current § 1354) to avoid newly applying attorneys' fees provisions to these two bodies of law. In the CLRC bill, this same restraint is gone. Not only is this expansion of attorneys' fees availability inappropriate for imported provisions that have nothing to do with an Open Meeting Act, attorneys' fees in this context would largely be one-sided, basically available only to a complaining member.

Left in the Corporations Code, board meeting provisions are not attached to fee awards. No important public policy is advanced by simply placing these corporate principles in an Open Meeting Act and then applying one-sided attorneys' fees provisions to be applied to them. This significant policy change requires study.

We have many concerns about the expansion and restatement of the CID Open Meeting Act, but some provisions are particularly troubling. First, Section 4540 (d) would provide that "if the board meets in executive session, a member who is the subject of the matter under consideration may attend and speak during consideration of the matter." Associations in litigation or meeting confidentially with counsel or undertaking extensive investigations into member conduct (particularly criminal conduct) will universally disregard this poorly-written provision, and with the full assistance of counsel. Surely the Commission did not mean what it wrote.

Secondly, to allow a member who may be disciplined to require a meeting with the board to be in open session invites chaos and, in some cases, physical violence. The member who wishes to intimidate a volunteer board by demanding an open meeting and bringing aggressive antagonists to it will succeed, not in an exchange of information on which decisions can be made, but in preventing an ordinary board from making hard decisions. It's hard enough for directors to try to conduct a business meeting in a room where an angry member will not be quiet, much less try to control a mob. Moreover, more hearings than imagined involve the board having to explore sometimes unsavory, salacious or very personal topics about owners or tenants, and many directors lack the skills to know what can and cannot be said without coming perilously close to saying actionable things. Until and unless the Legislature gives association boards legislative-like immunities, such sessions must never be required to be open. To insert provisions of such practical import into a non-substantive bill is simply misleading.

The many concerns expressed about the scope and effect of the proposed CID Open Meeting Act require the extended study that we urge the Legislature to give to this bill.

Further Mandatory Development of Rules

SB 61 (Battin) (today, §§ 1363.03, 1363.04 and 1363.09) required all associations to develop "voting and election rules." Today such rules have become yet a *fourth* source of authority that must be checked in dealing with member voting but, besides that concern, developing these rules were estimated to have cost complying associations millions of dollars. Beyond that, the new SB 61 procedures were in many ways so out of sync with existing bylaws that many associations opted to amend their bylaws to create consistent, sensible procedures. Those bylaw amendments took a further investment of legal and administrative dollars, but it didn't end there. For many associations, the later enactment of SB 1540 (Battin) - to "clean up"

procedural uncertainties in SB 61 - caused enough changes in the original elections statute that yet *another* round of multi-million dollar rule adjustment was needed.

The CLRC bill would add still *more* requirements to the voting and election rules of each association, among them, a puzzling "any rule required to implement this article" and, also new, "the loss or restoration of a member's voting privilege," "the calculation of voting power," and "procedures for the use of proxies" if the governing documents permit their use. If the Legislature approves this measure, every association's rules will *again* need to be changed. Regardless of whether these might or might not be good ideas, *adding* requirements to voting rules, without concern for costs, is inappropriate for a non-substantive bill. These and many other substantive changes in the voting and election statute, as well as their attendant cost, have not been scrutinized and do not belong here.

To add to the financial stress, the proposed new "member handbook" (Section 4810) would add a *new* requirement that each association develop a "discipline policy, including a schedule of penalties for violations of the governing documents." This added requirement will set off yet *another* round of rule-making that must be tailored to each association's individual governing documents, a process similar to the voting and election rules and at a similar cost. Under the current Act, associations are not required to have an enforcement policy separate from their governing documents, nor must they have any schedule of penalties unless they have the authority to levy fines and wish to impose them. This proposed provision is new, substantive, and has significant fiscal implications. No one has explained this new interest in preparing separate policies, when bylaws already contain disciplinary provisions and are readily available to the members.

Section 4810's new member handbook concept is so unbridled it would require boards to include in it "[a]ny other information that is required by law or the governing documents." There are numerous cross-references; each has to be explored. Even so, hidden in various places in the proposed new Act are even *more* requirements for information to go into the handbook. For some reason not all requirements are cross-referenced in Section 4810.

New Association Duty to Distribute Information to Buyers

A hallmark of the Davis-Stirling Act - and one that has been discussed and supported in court opinions - is that a *selling owner* has a duty to give a buyer specified copies of documents, statements, and information about the association and that the limit of the *association's* involvement is to cooperate with selling owners who request these materials. The legal protections and practical aspects of this are unquestionable. However, the CLRC bill would jettison these protections and place an affirmative duty on every *association* to provide a copy of the member handbook to each new owner.

Why is a member handbook not simply a document, like any other, that a seller obtains from the association and gives to a prospective purchaser? There is no important policy advanced by shifting this burden, cost and liability to associations, when there are many practical reasons to keep these practices uniform. If the point is to tell buyers about the association that they will shortly become members of, the appropriate time to do that is *before* transfer, not afterwards. This substantive change in the law should be rejected.

Reduction of Assessment Collection Remedies

Current Section 1367.4 provides that an association may collect assessments that are under $1,800 or delinquent less than one year (1) through a lien that cannot yet be foreclosed, (2) through an action in small claims court or (3) in any other manner provided by law. The CLRC bill would eliminate the last of these options. This language was negotiated during lengthy debate over SB 137 (Ducheny). Discarding it would be another substantive change in the law. Anything that reduces an association's assessment collection remedies reduces its ability to function and to meet its obligations.

Expansion of Attorney General Jurisdiction

Proposed new Section 4955 significantly expands the number of issues over which the Attorney General's office would be permitted to exercise jurisdiction. Current law extends such jurisdiction to questions related to *elections*, but the CLRC bill would expand that concept to cover *document inspections* and *record keeping*.

Disputed document requests are a most common type of association/member dispute. Adding this one category alone to the list of AG investigations and actions would vastly expand the AG's workload. In turn, the record *keeping* provisions in the CLRC bill (Section 4775) are significant and would arguably require thousands of documents to be retained, which will add unrealistic costs to association budgets to maintain, verify, update and monitor records. There is reportedly no funding for the AG's office to undertake more than cursory letter-writing with respect to election disputes. What would be done here would be to create only an illusion of redress, which should not be acceptable.

Elimination of Exemption from Reserve Studies for Associations with Limited Maintenance Duties

Current Section 1365.5 exempts from the requirement to perform reserve studies those associations whose current replacement costs for components are less than one-half of the association's annual budget, less reserve contributions. The proposed new law would eliminate that exemption (at least, we haven't been able to locate it), without explanation or debate, and would require *all* associations to comply with the proposed new triumvirate of reserve duties - to obtain an inspection, to prepare a reserve funding study, and to make a reserve funding plan. The new costs of statutory compliance for formerly exempted associations are not examined or disclosed.

Reserve Funding Plans to Again Include "Projected Income"

Not long ago it came to the attention of the Legislature that reserve studies and funding plans could be wildly inconsistent from one development to the next. One reason for the problem was the ability of associations to include what is essentially "hoped-for" revenue from members and "maybe" transfers from the operating fund in calculating how well an association was funding its reserves. However, too often these monies never materialized, boards were persistently over-optimistic, and inter-fund liabilities to the reserves were still counted (even

including monies that were spent on operations, leading to shortfalls that accumulated over many years). The Legislature resolved this dilemma by mandating in current Section 1365(a)(2) that reserve calculations must be prepared based on "actual cash or cash equivalents" and *not* on projected income or transfers. Only very limited assumptions about rates of return on invested reserves can be used, pursuant to Section 1365(a)(4).

The CLRC bill would *again* allow associations to use projected income in stating the health of their reserves. Hard lessons already learned should not be repeated. This is a significant substantive retreat in the law.

Obligation to Give Out Members' Email Addresses

Current records access laws (§ 1365.2; Corporations Code § 8330 et seq.) provide that members may request and receive membership lists containing the names and addresses of the members. Section 1365.2 allows members to "opt out" of the list to protect their privacy, if they are aware of the right and provide written notice to their associations.

Proposed new Section 4700(a) would also require associations to give requesting members the email addresses of other members. This is an unprecedented intrusion into members' and directors' privacy, which is otherwise zealously guarded in the records access law and when reporting the president's contact to the secretary of state. (See § 1363.6, subd. (e).

Many people have email addresses through their employers, which are often subject to some degree of employee restriction on personal use. Moreover, email is personal, far more so than materials sent through the mails. When email addresses leak out, both members and directors can be harassed or bombarded by an angry member, a very unpleasant experience. Though members can opt out, most would have no idea their association might be obligated to give out such information and facilitate such communications without their consent. Unwanted emails can be punishing and intense, sometimes profane, defamatory or irrational. Requiring managers and boards to release email addresses is bad policy for California.

Burden of Proof Shifted / Records Requests

Proposed new Section 4735(e) provides that "[t]he association bears the burden of proving the legal grounds for noncompliance with [a] records request." Proving the propriety of a request ought to be the burden of the complaining party. The statute sets out the requesting party's right and does not provide grounds for association refusal other than a belief that the record will be used for an impermissible purpose or that disclosure of the record will violate an established legal privilege or a member's constitutional rights.

Experience shows that members often do not read the statute carefully and are unaware that there are reasonable limits to their right to request records. If an association does not comply with a records request, it must tell the member the reason. Thereafter, the burden of proving that the association violated the statute should rest on the requesting owner.

Expanded Liability for Associations / Mandatory Redaction

Current Section 1365.2 provides that associations *may* redact or withhold certain records. Proposed new Section 4735 would make redaction or withholding *mandatory* for specified types of information, generally involving the types of supporting documents that can number in the thousands. Section 1365.2 already places directors and managers at risk, providing that they can be liable for injury claims because of a failure to redact or withhold information where the failure was negligent. Mandatory redaction or withholding is an unrealistic operational burden to place on associations. Claims in negligence per se, where breach of duty is presumed, can be expected if these requirements are imposed.

Small Claims Court Jurisdiction / Delay or Reversal of Important Association Votes

Proposed new Section 4735(d) provides that a small claims court can postpone member votes "if association delay in providing access to a record would prejudice the requesting member's interest in a decision to be made at the meeting." Section 4735 would also empower a small claims court to appoint an investigator or accountant to inspect or audit association records at a requesting member's behalf. It would also give a small claims court jurisdiction to authorize the "tolling of any deadline affected by association delay in providing access to a record."

Such jurisdiction properly belongs with the superior court, notwithstanding the amount demanded by an owner, as important interests of an association can be seriously jeopardized if, for example, a vote on a multi-million dollar assessment could be delayed or even reversed in small claims court on the request of one owner. The act of tolling "any" deadline affected by association delay could have many unknown legal effects. Such un-debated and substantive additions to the Act are inappropriate.

Missed Opportunities

Despite comments from legal experts that current Section 1364 fails to clearly distinguish maintenance and repair responsibilities for associations and owners, the CLRC itself deemed the provision clear enough and did *not* clarify it.

Similarly, the current Act builds in flexibility in the type of nonprofit corporation an association can be. However, in at least two places the Act applies only to nonprofit *mutual benefit* corporations. An example is where ADR is applied to enforcement of corporate law. Wherever a specific reference is made, only that body of law or only those associations organized under that body of law are subject to, or can take advantage of, that section of the Act. These are clearly incorrect references in current law that should have been corrected in a revised new Act.

Regulations of the Federal Communications Commission long ago superseded all conflicting provisions in the state's satellite dish and antenna law for CIDs, found at Section 1376. Despite being preempted in all but possibly one remaining provision of Section 1376, the

proposed new Act retains current state law. Much misinformation results from this interplay of federal and state law and should be clarified.

In our April 18, 2008 letter, we pointed out several significant problems with the proposed new Act, including a serious error in the definition of "exclusive use common area." The bill was recently amended, but our concern remains unaddressed.

* * * *

Unless consideration of the CLRC bill is deferred, California will have many new provisions and changes in the law with which to contend, going far beyond mere re-organization, simplification and clarification of the law. New and changed legal requirements range from silly to serious, but all will need to be recognized and dealt with.

Among those spotted so far are the following:

All meetings will have to be held indoors. The Act will apply to association members who are not even owners. Boards will be allowed to use association funds to promote the election of particular candidates. Full-time employee managers will be excluded from exceptions in the agenda laws. Delegate voting will somehow have to be done by secret ballot.

The new law will guarantee future litigation about who pays for relocation costs when a building is seriously damaged. It could now require condominium associations to repair owners' *units* in the event of termite damage. It will require associations to keep any and all deeds that come its way permanently in its files. It will confuse planned developments with community apartment projects. It will contain internally conflicting provisions about proxies. It will suggest that members can't opt to amend their bylaws to provide that *all* decisions will be made by secret ballot, and it will dismiss bylaws that have been amended to achieve that goal. It will prevent associations from using post office boxes to return secret ballots.

It will impose three-year timeframes on reserve investigations, studies and funding plans, but not necessarily the same three-year timeframes, so that disclosures can be skewed. It will prevent boards from calling special membership meetings in less than *35 days*, while it only takes 10 days currently. It will allow any member to simply call a membership meeting if he or she disagrees with the reason their board will not and to demand reimbursement of costs. It will continue to confuse the obligation of managing agents for money handling, albeit in a different way. It will perpetuate the confusion between the concepts of 30-day mailed secret ballots and conducting elections at membership meetings. It will provide that nominations do not have to be handled in conformance with an association's bylaws.

It will impose $500 penalties and attorneys' fees if a board fails to put certain information in member handbooks. It will not tell how to handle interested directors since it cross-references provisions in the Corporations Code that only apply to assets held in charitable trust. It will incorporate yet another legal standard for boards to meet – "in good faith and with a substantial basis" - if they deny an association records request; civil penalties and one-sided attorneys' fees also attach. It will require boards to repeatedly meet and make records-access

decisions on short notice, to satisfy new response-time requirements when members request records that are not accessible.

It will override the timeframe in the Corporations Code to contest a director election. Absent members will be specially permitted to vote electronically at a membership meeting, even though they have an equal opportunity to vote in secret through the mails. The law will be silent about whether a director has a right to notice of board meetings. Directors won't be allowed to meet off-site in executive session. Proxies in director removal votes will not be required to state the specific purpose of the proxy.

With so many details and analytical connections to make, this disorganized and paraphrased version of the Act, if approved, will take years before the wealth of changes that it makes are spotted. The costs for basic re-education, re-tooling DRE applications, forms and document requirements, revamping templates from which governing documents are built, re-writing legal treatises, document amendments, new mandatory policies, and legal opinions about what the new law means will financially burden associations for a long time to come. The legal consequences of the CLRC's choices of organization, words and substantive changes will promote misunderstandings, disputes, ADR, litigation – the opposite of what was intended.

What was needed is a far simpler organizational style, a far more concise statement of CID law, a minimum of cross-references, and respect for most of the words that comprise the current Act. A revised Act should be readable, comprehensible, sensible and usable. As drafted, the CLRC bill is not good law for California, and it cannot be fixed in its current state. This bill should not go forward without significant scrutiny, questioning, and study, which cannot be done in the remaining time left in this legislative session.

Thank you for your consideration of our views and for accepting the seriousness with which we write. We respect the CLRC for its contributions to keeping California law fresh and viable, but are compelled to point out that it has stumbled here. We urge the Legislature to set this bill aside for a measured, experienced legal review, starting with the fundamentals, go back to the existing Davis-Stirling Act and rework *only* that which promotes the goals of better organization, simplicity and clarity.

If we can answer any questions, please contact either Steven Weil or Sandra Bonato.

Very truly yours,

25 Concerned Attorneys
(List Attached)

cc: Assembly Member Lori Saldaña
California Law Revision Commission, Attn: Brian Hebert, Executive Secretary
Benjamin Palmer, Consultant, Senate Judiciary Committee
Mark Stivers, Consultant, Senate Transportation and Housing Committee
Drew Liebert, Chief Counsel, Assembly Judiciary Committee

Lisa Engel, Chief Consultant, Assembly Housing & Community Development Committee
Chris Kahn, Deputy Chief of Staff and Legislative Secretary, Governor's Office
Curt Augustine, Deputy Legislative Secretary, Governor's Office
Mike Petersen, Consultant, Republican Senate Caucus, Judiciary
Ted Morley, Principal Consultant, Republican Senate Caucus, Transportation & Housing
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William Weber, Consultant, Republican Assembly Caucus, Housing
Elaine M. Andersson, Chair, Real Property Law Section, California State Bar
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LIST OF ATTORNEYS

The attorneys listed below often range on opposite sides of legislative issues. Despite our differences, we are all seriously alarmed over AB 1921 (Saldaña).

The professionals whose names appear below are among the most experienced attorneys in California practicing in the field of common interest development and community association law. Counted among our members are the published authors of major legal treatises in this field, whose authoritative works are cited regularly in the courts. Members of our group have published articles, are recognized speakers on a national stage, and teach DRE-approved continuing education courses to licensees and help certify present and future leaders of community associations. Members of our group have leadership roles in the State Bar and in its Real Property Law Section and Subsection on Common Interest Developments. Members of our group are consulted closely by the DRE in developing state regulations that govern the creation of common interest developments. Members of our group were involved at the formative stages of the original Davis-Stirling Common Interest Development Act and know its roots.

The biography of each of the attorneys listed below was submitted with our April 18, 2008 letter. If copies are desired, please let us know.

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