Study H-857 February 13, 2009

Second Supplement to Memorandum 2009-14

Small Associations (Public Comment)

The Commission has received more letters commenting on the issues discussed in Memorandum 2009-14, relating to small common interest developments ("CIDs"). The letters are attached in the Exhibit as follows:

The points raised in these letters are summarized below. In the interest of simplicity, the term "unit" is used in this memorandum to mean a separate interest in a CID.

GENERAL RESPONSE

Support

Duncan McPherson, a Stockton attorney specializing in real property matters, is generally supportive of the direction of the study:

> I received the Commission's Memorandum 2009-14, and reviewed it with Nathan McGuire and others in our firm that represent associations. We are pleased to see that the Commission is moving rapidly to review the issues presented by CIDs with small numbers of members. The Commission has identified many of the impacts on small associations, caused by the formalities of the Davis-Stirling Common Interest Development Act ("Act"), as it currently exists. The tables showing the breakdown in the size of associations and their income were especially helpful in showing the scope of the issue. Our experience suggests that associations that have one hundred (100) separate interests, or less, and do not consist of multi-family housing units, are not likely to have on-going legal advice or professional management and, more often than not, do not observe the member election provisions of the Act

> and other provisions of the Act, either due to the lack of knowledge regarding the procedures, or due to disinterest in complicating the operation of the association. Compliance with the election formalities and other requirements of the Act which, in most cases, did not exist at the time these associations were formed, would substantially increase the association's assessments, which would not be popular with the owners. To comply with the Act, such associations would be forced not only to pay the costs associated with membership elections, as required by the Act, but for all practical purposes would be required to employ professional management which would add significant additional costs to the association and would substantially raise assessments.

See Exhibit p. 1.

Mr. McPherson also suggests that simplified governance in small associations could remove an impediment to the construction of affordable housing:

> Unfortunately, the complexities of the Act that have been added by the legislature in recent years have been far more effective in increasing business for association managers and association attorneys than in solving fundamental problems in association operation. Also, they have made it difficult for real estate developers to justify using associations in small developments, due to the costs of their operation, which in our view is not desirable. These high costs translate into high assessments which serve to make it harder for buyers to qualify for loans to purchase homes in these developments. Often, this complicates adding high density attached housing to subdivisions, to satisfy low income housing requirements, thus making it harder to produce housing to serve low and moderate income households. It would be desirable to make it easier for small or de minimis associations to operate economically within the frame work of the Act and thus encourage familiarity and compliance.

See Exhibit p. 1-2.

Richard Nichols writes on behalf of the board of directors of the Grassy Run Homeowners' Association ("GRHA"). GRHA supports the idea of simplified governance procedures for small associations:

> [T]here should be consideration given to something like a "Davis-Stirling Lite," with many if not most of the requirements of the Act either deleted entirely or made elective as to small associations. … [E]verything that requires the expenditure by associations of money for administrative purposes is something that detracts from the very purpose of the associations' existence, i.e., community benefit.

See Exhibit p. 11. Mr. Nichols also notes that the Davis-Stirling Act is written in a way that makes it very difficult for nonlawyers to understand. That compounds the problems of small associations, which must often rely on homeowner volunteers to read and understand the law. See Exhibit pp. 11-12.

Bob Sheppard, writing on behalf of the Walnut House Cooperative, supports the goals of the study, "which will unburden many of us from overly demanding procedures." See Exhibit p. 15. He states that many small associations

> are self-managed, where many members participate with each other in the operation of their communities. Because of this, there is a significant amount of social interaction and community-building and thus less reason to require more formal election procedures.

Id.

Alternative Views

Kazuko Artus agrees that some simplification of governance procedures would be helpful. See Exhibit p. 5. However, she does not agree that simplified governance procedures should be limited to *small* associations:

> I do not believe, however, that the size of association should be the criterion for exempting associations from any governance provision of the Davis-Stirling Act. The necessary condition should be the preference of association members.

Id. She suggests that simplified procedures should be available to any association, regardless of its size, so long as there is unanimous member consent to use of the simplified procedure. *Id.*

Ms. Artus also objects to the implication, in Memorandum 2009-14, that the law should be designed to accommodate those who are ignorant of the law. *Id.* She points out that the directors of a large and well-financed association may also be ignorant of the law. *Id.* That is undoubtedly correct, but the staff believes that the risk of directors being ignorant of controlling law is much higher in associations that are too small to afford professional management and legal counsel.

Ms. Artus cautions the Commission against depriving owners in small associations of protections afforded in the Davis-Stirling Act. That is an important consideration that should be kept in mind. In the context of election procedures, the staff believes that the procedures can be simplified without

losing any of the substantive protections provided by existing law. It remains to be seen whether that will also be true with respect to other aspects of CID law.

Gregory Tobey agrees that there are differences between large and small associations. He notes that most large CIDs are professionally managed, with access to legal advice. He believes that small associations "present the most problems." He then raises a general complaint about homeowner association governance: If a board violates California law or its own governing documents, a homeowner often has no recourse other than to file a lawsuit. See Exhibit p. 5.

Mr. Tobey seems to be arguing that the Commission should shift its focus to the need for affordable nonjudicial remedies for board misconduct.

The Commission has already studied that topic extensively. The Commission recommended a number of improvements to existing ADR provisions and recommended that associations be required to provide an internal dispute resolution mechanism for homeowners to use, at no cost to the homeowner. See *Alternative Dispute Resolution in Common Interest Developments*, 33 Cal. L. Revision Comm'n Reports 689 (2003). Those recommendations were enacted into law. See 2004 Cal. Stat. ch. 754. The Commission also recommended the creation of a state ombudsperson for CIDs, to provide information and to help resolve disputes. See *Common Interest Development Ombudsperson*, 35 Cal. L. Revision Comm'n Reports 123 (2005). That recommendation has been approved by the Legislature twice, but vetoed by the Governor both times. See AB 567 (Saldaña) (2008); AB 770 (Mullin) (2005).

DEFINING "SMALL ASSOCIATION"

Number of Units

Bob Sheppard supports defining "small association" by reference to the number of units in the development. See Exhibit p. 15.

Mr. Sheppard suggests that the Commission consider defining "small association" differently for different issues. However, if a single definition is used for all issues, he suggests that it be set at 50 units or fewer. He believes that would encompass "all known cohousing communities in California and many limited-equity housing cooperatives." *Id.*

If the definition is based on the number of units, Kazuko Artus suggests a slight (but significant) modification of that approach. She believes that the definition should be based on the number of *members* in the association, rather

than the number of *units*. See Exhibit pp. 8-9. This distinction will matter in a development where one person owns more than one unit. That person would arguably hold only a single membership despite owning multiple units. Under that approach, an owner in a 10-unit association who owns 5 units would hold only one membership. The association would be classified as a 6-member association despite the fact that there are 10 units.

That approach would better reflect the number of people available to share the work of running the association. However, that approach might be too unpredictable over time. Changing ownership of units could cause an association to fluctuate between large and small status.

Another problem might arise where an association's governing documents provide that joint owners of a unit are all "members." In such a community, the status of an association as large or small might fluctuate with changes affecting joint ownership (e.g., dissolution of marriage).

Multi-Factor Definition

Some of the commenters support using more than a single factor, in combination, to define "small association."

Duncan McPherson believes that the practicalities of governance are significantly different in a development with detached homes, as compared with a development in which the units are attached as part of a common structure (like a high-rise condominium). In the latter case, the association's maintenance responsibilities are more significant, and the risk of disputes between neighbors is increased. He suggests that governance in attached associations has a greater impact on owner interests and should be governed by more formal procedures. See Exhibit pp. 3-4.

Specifically, Mr. McPherson recommends that in an *attached* development, a small association should be one with 50 units or fewer. By contrast, in a development with *detached* housing, "small association" should include a development with 100 units or fewer. *Id.* He invites comment on how the line should be drawn to distinguish between attached and detached developments.

GRHA also believes that the number of units should not be the sole consideration in defining "small association." (If it is the sole consideration, GRHA recommends including associations with 100 or fewer units). See Exhibit pp. 12-13.

Instead, GRHA suggests that the definition should be based on two alternative tests. A small association should be defined as an association with fewer than a specified number of units *or* less than a specified level of annual income. Satisfaction of either test would be sufficient to meet the definition.

GRHA also recommends that the definition of "small association" take into account the nature of a development and the extent of its duties. This is similar to the points made by Mr. McPherson and others, that an association with only modest responsibilities should be governed by informal statutory procedures.

However, the burden of *statutory* duties does not always correlate to the extent of an association's general responsibilities. Member election procedures provide a good example of why this is so. The cost and difficulty of administering an election is directly related to the number of votes that will be cast in the election. An election in which 25 votes will be cast is easier to conduct than one in which 250 votes will be cast. That is as true in a high-rise condominium with extensive maintenance responsibilities as it is in a development of detached homes with minimal maintenance.

That said, the difficulty of some statutory duties will correlate to the extent of the association's maintenance responsibilities (e.g., the obligation to develop a reserve plan for future maintenance responsibilities).

Multiple Definitions

Kazuko Artus believes that there should be more than one definition of "small association," each adapted to its purpose. See Exhibit p.8.

Bob Sheppard makes a similar suggestion. See Exhibit p. 15.

Annual Income

Another possible approach would be to define "small association" by reference to an association's annual income.

Bob Sheppard raises an interesting new objection to that approach. He explains that, in a cooperative, the association itself might hold the mortgage on the entire development. The monthly assessments paid by the members would include their share of that mortgage, in addition to a share of the operating costs of the association. In such a development, assessments would be much higher than is typical for CIDs and would be a poor measure of whether the association is small or large.

GRHA makes a good suggestion regarding the use of annual income in defining a "small association." If that approach is followed, income should be

limited to income that is generated through the *regular* assessments. See Exhibit p. 13. That would avoid the wild fluctuations that might otherwise occur if an association imposes a large special assessment, or receives an unexpected surge in other income (e.g., a judgment in a lawsuit).

Finally, Kazuko Artus proposes a way to avoid the problem of a statutory dollar amount that is not adjusted for inflation over time. She suggests that the statute could specify the initial dollar threshold, but provide that the dollar limit changes pursuant to a specified inflation index, so that the statutory amount would track real dollars over time.

The use of an automatic cost of living adjustment has obvious appeal, but would be difficult to implement. A provision that simply declares that the stated amount must be adjusted according to some index would require that homeowners calculate the adjusted dollar amount, in order to determine whether their associations are large or small. In close cases, the calculation would need to be made annually. This would seem to invite confusion, error, and instability.

One way to address that problem would be to designate some public entity and require it to make periodic calculations of the statutory amount. The adjusted amount could then be published for public reference. The Commission followed that approach in another recommendation, relating to the amount of exemptions from the enforcement of judgments (the Judicial Council was required to make the calculation and publish the adjusted amount). See *Exemptions from Enforcement of Money Judgments: Second Decennial Review*, 33 Cal. L. Revision Comm'n Reports 113 (2003); Code Civ. Proc. § 703.150.

That approach would be hard to replicate in the context of CID law, because there is no public entity with ongoing jurisdiction over CID governance.

ELECTION PROCEDURE

Duncan McPherson commends the Commission for identifying a number of problems in the existing statutory member election procedure. See Exhibit p. 2. He identifies other problems in the existing procedure. *Id.* He urges the Commission to address those problems generally, and not just in the context of special rules for small associations.

Kazuko Artus also asks that the Commission study general problems in the existing elections statute. See Exhibit pp. 7-8.

Bob Sheppard identifies a number of issues with the existing statute and proposes changes to make it more workable. See Exhibit pp. 16-17. He also expresses general support for the proposed in-person voting procedure set out in Memorandum 2008-14, at p. 10, subject to his suggested improvements.

To the extent that suggestions regarding elections are directed at the existing election procedure that applies to *all* associations, those comments are beyond the scope of the current study. They will need to be addressed in a later phase of the Commission's review of CID law. To the extent the suggestions bear on the proposal for a simplified voting procedure for small associations, they are discussed below.

Proxy

Bob Sheppard notes that existing law provides that a proxy may only be given to another member of the association. See Civ. Code § 1363.03(d)(1)(A). That is stricter than the Corporations Code, which allows a proxy to be given to any person (e.g., a creditor). See Corp. Code § 7613.

Mr. Sheppard asserts that the stricter rule about who may receive and vote pursuant to a proxy can cause problems (e.g., making it harder to achieve a quorum) and he suggests that the restriction should be relaxed. See Exhibit p. 16.

Mr. Sheppard raises a good point. It is not clear to the staff why the recipient of a proxy should be limited to a member. As Mr. Sheppard points out, an absentee owner may wish to give a proxy to the person renting the owner's unit. That would provide a simple way for the absentee owner to participate in an election and be counted for purposes of a quorum. The Commission should consider adding a paragraph to the proposed in-person voting procedure (proposed Civ. Code § 1363.08, set out at Memorandum 2009-14, p.10), along the following lines:

> Unless the governing documents provide otherwise, a proxy may be given to any person, including a non-member.

That would relax the statutory limitation, while respecting the association's own rules.

Secrecy

Bob Sheppard notes that requiring a secret ballot may be at odds with the preferred governance model in some small associations. He suggests that some

associations may be comfortable with a show of hands as a way of registering votes. See Exhibit p. 16.

The staff agrees that some associations may wish to use an open voting process. However, open voting could be problematic. Especially in a small community, social pressure may cause a person to vote contrary to the person's own wishes. Secrecy, which the proposed law would achieve at minimal cost, avoids that sort of group pressure.

Notice

The proposed in-person voting procedure would require a 30-day notice period before an election is held. That is consistent with the notice period in existing Civil Code Section 1363.03.

Bob Sheppard believes that the 30-day rule should be subordinated to an association's governing documents, so that an association may give a shorter period of notice (e.g., 10 days) if it wishes to do so. See Exhibit p. 16.

The staff is unsure whether a period of less than 30 days should be permitted and invites public comment on this issue.

Quorum

Bob Sheppard is concerned that the proposed in-person voting procedure would mandate the manner in which a quorum is to be calculated and would be incompatible with some association's governing documents. The provision at issue is proposed Civil Code Section 1363.08(a)(2), which provides:

> (2) The election shall be held at a meeting of the members at which a quorum is present, either in person or through written proxies.

The staff does not see how that language would mandate any particular method of determining a quorum, except that it would allow proxies to be counted for that purpose.

To avoid overriding governing documents that do not permit proxies, the language could be revised as follows:

> (2) The election shall be held at a meeting of the members at which a quorum is present~~, either in person or through written proxies~~. If the governing documents permit the use of a proxy, a proxy shall be counted in determining a quorum.

Run-Offs

The proposed in-person voting procedure includes a provision allowing an immediate run-off to resolve a tie:

> (6) If members representing a majority of the voting power present at the meeting agree, a second vote may be immediately conducted to resolve a tie.

Proposed Civ. Code § 1363.08(a)(6).

Bob Sheppard is concerned that this language would trump his association's procedure, which is to hold a second election. If the second election also results in a tie, lots are drawn. See Exhibit p. 17.

The staff does not see how the language in Section 1363.08(a)(6) would interfere with the procedure used in Mr. Sheppard's community. Nonetheless, it might be appropriate to use more permissive language, along the following lines:

> (6) If members representing a majority of the voting power present at the meeting agree, a ~~second vote~~ run-off may be immediately conducted to resolve a tie.

Comment language could then emphasize that the statute does not specify a procedure for conducting a run-off. The procedure would either be specified in the association's governing documents or agreed to by the members participating in the election.

Votes Cast Prior to Meeting

Bob Sheppard suggests that the simplified procedure should permit votes to be cast before a meeting, by placing them in a locked box held by a neutral. See Exhibit p. 17. That would significantly complicate the proposed procedure. Provisions might need to be added governing selection of a neutral, authentication of pre-meeting ballots, and custody of those ballots.

The proposed language provides a simpler solution: A person who cannot attend an election meeting can give a proxy in advance of the meeting. The proxy would be authenticated and voted at the meeting.

Write-In Candidates

A previous commenter suggested that the simplified voting procedure should expressly address the possibility of write-in candidates. In response, the staff recommended that the Commission consider adding language to expressly

authorize the use of write-in voting. See First Supplement to CLRC Memorandum 2009-14, at p. 5.

Bob Sheppard opposes the suggested change. He is concerned that members will write in the names of persons who are not willing to serve if elected. That would complicate elections in his association. See Exhibit p. 17.

That is possible. It is also possible that a member might write in the name of a public or fictitious figure, as a protest vote. Nonetheless, the staff is not convinced that the risk of such mischief is high enough to justify prohibiting the practice of write-in voting altogether.

Respectfully submitted,

Brian Hebert
Executive Secretary

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February 4, 2009

Mr. Brian Hebert
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, California 94303-4739

Re: California Law Revision Commission Memorandum 2009-14
Small Associations (CID)

Dear Mr. Hebert:

I received the Commission's Memorandum 2009-14, and reviewed it with Nathan McGuire and others in our firm that represent associations. We are pleased to see that the Commission is moving rapidly to review the issues presented by CIDs with small numbers of members. The Commission has identified many of the impacts on small associations, caused by the formalities of the *Davis-Stirling Common Interest Development Act* ("**Act**"), as it currently exists. The tables showing the breakdown in the size of associations and their income were especially helpful in showing the scope of the issue. Our experience suggests that associations that have one hundred (100) separate interests, or less, and do not consist of multi-family housing units, are not likely to have on-going legal advice or professional management and, more often than not, do not observe the member election provisions of the *Act* and other provisions of the *Act*, either due to the lack of knowledge regarding the procedures, or due to disinterest in complicating the operation of the association. Compliance with the election formalities and other requirements of the *Act* which, in most cases, did not exist at the time these associations were formed, would substantially increase the association's assessments, which would not be popular with the owners. To comply with the *Act*, such associations would be forced not only to pay the costs associated with membership elections, as required by the *Act*, but for all practical purposes would be required to employ professional management which would add significant additional costs to the association and would substantially raise assessments.

Unfortunately, the complexities of the *Act* that have been added by the legislature in recent years have been far more effective in increasing business for association managers and association attorneys than in solving fundamental problems in association operation. Also, they have made it difficult for real estate developers to justify using associations in small developments, due to the costs of their operation, which in our view is not desirable. These high costs translate into high assessments which serve to make it harder for buyers to qualify for loans to purchase homes in these developments. Often, this complicates adding high density attached housing to subdivisions,

to satisfy low income housing requirements, thus making it harder to produce housing to serve low and moderate income households. It would be desirable to make it easier for small or deminimis associations to operate economically within the frame work of the *Act* and thus encourage familiarity and compliance.

The Commission is to be commended for pointing out some (but by no means all) of the problems that make *Section 1363.03* of the *Act* difficult to use in practice. This is a code section which has caused major debates between experienced lawyers, as to how elections are to be conducted. It is not a good situation where something as fundamental as the procedures for member elections can not be easily understood by persons having substantial experience in this area. The law should have the effect of eliminating controversies not creating additional controversy.

As you know, there are many problems with the existing election law. We have seen a substantial increase in controversy and challenges related to elections, since the passage of the election law. It is not clear whether or how cumulative voting is to be used in cases where an association's governing documents permit the use of cumulative voting, only if a member states that member's intention to use cumulative voting at a membership meeting. The requirement for a member to sign the outside envelope is a problem; since many members refuse to sign the envelope or return ballots as a result of privacy concerns (this could be easily solved by allowing the signature to be placed elsewhere or by eliminating the requirement). Proxies are difficult, if not impossible, to use correctly in a written balloting system, both because of the challenge of creating a valid proxy and the procedural complications associated with using one with the current election requirements. As a result, serious consideration should be given to eliminating the use of proxies. However many large associations have only been able to obtain quorums of members by use of proxies and the difficulty of using proxies with the present law has prevented them from being able to hold membership elections.

The election law is also difficult to comply with when there is delegate voting, when votes are cast by a sub-association within a master association, and when members have variable voting power. As an example, illustrating the problem related to variable voting power, we recently dealt with a non-residential association that had members with as few as 30 votes and as many as 400 votes. To strictly comply with the election law and preserve the secrecy of votes, the association would have been required to send out 400 separate ballots to a single member. This issue exists in both commercial and residential associations, but the voting power is typically more disparate in non-residential associations. The issue faced by most associations we deal with is voter apathy. Many of these associations incur the significant expense of mailing out ballots, in compliance with the election law, even though there is virtually no chance of achieving a quorum. In these instances, it should be made clear that associations have the option of extending the deadline for the return of ballots (regardless of what is provided for in the governing documents), tabulating the votes and appointing the top vote-getters to the expiring positions, or keeping the positions as is and filling vacant seats, if any, by appointment in accordance with the governing documents (this option appears to be the most often utilized by associations in our experience). We would also be in support of a reduced quorum overriding whatever quorum is provided for in an association's governing documents, either as it relates to all director elections or limited to an extension period.

Some of the problems with the election law can be minimized through governing document amendments, but many of the associations in the most desperate need of amendments are not in a position to amend the governing documents, because of the inability to obtain the necessary votes. For this reason, we recommend a revision of *Section 1356* of the *Act* to permit amendments to governing documents to be adopted where less than 50% of the members vote, but where a large majority of the votes cast were in favor of the amendment. The procedure could require associations to take additional measures, including extending the normal balloting deadline for a specified time period.

With respect to both director elections and governing document amendments, we do not believe that an association should be held hostage by those members of the association who do not care enough to return a ballot, provided sufficient notice of the proposed change is provided to all members (notice of an amendment would be provided to all members as part of the balloting process and in writing not less than 15 days prior to the election).

The primary purpose of this letter, however, is to discuss where the line should be drawn between CIDs which qualify for the simpler procedures, the so called "small associations" and those CIDs that do not. We believe that the definition of "small associations" should include CIDs with many more separate interests than the twenty-five (25) suggested in the Memorandum, subject to certain limitations. One reason for choosing a higher minimum is that it is evidently difficult to obtain good professional management for CIDs with less than one hundred separate interests in many urban areas. Another reason is that there are major distinctions between CIDs other than the number of separate interests. One of these distinctions is the impact that the Association has on the owners, members and other occupants of a CID. An association managing a multi-story, multi-family development generally has much more day to day impact on the lives of the owners and other occupants than does an association managing a single family detached home subdivision located on public streets. There are a number of reasons for this, but the main reason is that in a multi-family development the association manages the physical building, its entry, its streets and driveway, and parking and often many services that are provided to the owners and other occupants. Also in a high density multi-family CID there are likely to be many more problems that occur between the occupants than would occur in a single family detached house subdivision and the association often becomes involved in these problems. In a high density multi-family CID the assessments are as a rule much higher than in a subdivision of single family detached houses because the association is collecting assessments to maintain the building or buildings in which the residential units are located, reserves for future maintenance and repairs and is providing insurance for the buildings as well as employing services such as landscaping and the like which in the single family house situation would be the responsibility of the house owner.

Due to these factors we would like to suggest that the definition of "small association" include at least one hundred (100) separate interests. However, in the case of an association that maintains the building, or buildings, that house the separate interests, or maintains the exterior of the separate interests, we suggest the definition should be restricted to CIDs with fewer separate interests. Fifty (50) separate interests might be appropriate in this case. This same result could be reached by making the "small association" definition be based on the amount of the assessments. However as the Memorandum correctly points out any definition based on association income or assessments, creates a problem of the dollar amount levels becoming obsolete due to the

inflationary nature of expenses and assessments. We have a large number of planned development associations in this area that have up to several hundred members but exist only to operate a community pool and park and have assessments of only a couple of hundred dollars a year. The existence of CIDs of this type would indicate that perhaps the upper limit for "small associations" should be two or three hundred separate interests, if the association has no responsibility for the maintenance of buildings containing the separate interests and access to the separate interests is through public streets. We would be interested if others reviewing the Memorandum have other practical methods of distinguishing associations that may need more formality from those that have a deminimis impact on their owners and members.

Our office also received a copy of a letter dated January 24, 2009, that Sam Dolnick sent to the Commission, regarding the financial review and auditing of Association finances. His letter raises a larger issue and that is how to revise the *Act* to make compliance by small associations reasonably economical and practical. The question is whether these revised procedures should be added to the sections containing the current procedures or whether a separate article or chapter should be set up containing all of the revisions relating to small associations so that the provisions are easy to access in one place. Having the provisions related to small associations in a separate article or chapter would avoid having those procedures changed when there are later amendments to the *Act*. This same issue already exists with regard to non-residential associations. It will be necessary to review the entire *Act* on a section by section basis and determine which provisions work in the context of small associations and which do not and evaluate what changes are be suitable to recommend to the legislature.

Very truly yours,

DUNCAN R. McPHERSON

DRM/clm
cc: Mr. Steve Cohen [scohen@clrc.ca.gov]
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1470 Golden Gate Avenue
San Francisco, CA 94115

February 4, 2009

Mr. Brian Hebert, Executive Secretary
California Law Revision Commission Attachment
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Dear Mr. Hebert,

Subject: First Supplement to Memorandum 2009-14

I would agree there are differences between small and large Common Interest Development Associations.

Most large CID Associations are professionally managed, with responsible legal advice.

It is the Small CID Associations being self-managed by lay people who present the most problems.

Under the current Davis-Stirling law, the only recourse of a Homeowner is to file a legal action for enforcement of the CC&R's and California Law. This presents an inherent disadvantage to address actions of the Board.

The Commission needs to address this inherent inequality. The current situation only benefits members of the California Bar Association.

While the current law in Davis-Stirling can use clarification, a reasonable person attempting to find direction can do so.

Small Association Board members should not be able to hide behind this "legal shield" when they have not attempted to acquaint themselves with pertinent California CID law.

Sincerely,

Gregory L. Tobey

Kazuko K. Artus, Ph.D., J.D.

5 February 2009

Mr. Brian Hebert
Executive Secretary
California Law Revision Commission

Mr. Hebert:

Re: Small Associations (Memorandum 2009-14)

Thank you for your efforts to make life easier for small CID associations. I heard of a small CID association which, before the 2006 amendments to the Davis-Stirling Act, maintained the practice of appointing its newest members to serve on its board and operated with no trouble. It would be good to leave a space in CID law in which such an association may legally select or elect directors by procedures simpler than the secret ballot method of Civil Code 1363.03.

Conditions

I do not believe, however, that the size of association should be the criterion for exempting associations from any governance provision of the Davis-Stirling Act. The necessary condition should be the preference of association members. Being unsure of what the word "optional" means in the staff recommendation on p. 5, I wish to urge that the adoption of the special procedures be conditioned, *inter alia*, on written unanimous consents of members (which would not be difficult to secure in small associations whose members maintain harmonious relationship among themselves) and be subject to reversal on one member's notice or on a change in the membership (e.g., on transfer of a unit to a person who was not a member when the unanimous consents obtained).

Inadequate Knowledge of the Davis-Stirling Act

You are not suggesting in the first full paragraph of p. 9, I hope, that the Davis-Stirling Act should be adjusted to protect associations that are ignorant of or ignore statutory provisions. The problem described in that paragraph is not limited to small associations. I belong to a CID association which is in the largest 20% in terms of the number of units and in the largest 10% in terms of annual revenue according to the tables on p. 4, and have served on its board over the past two years. The visibility of the Davis-Stirling Act is so low that very few of my fellow members are familiar with the Act, even though all of them are highly literate and

numerate and many are members of the State Bar of California. I might have remained totally ignorant of the Act but for someone's chance remark, and am sure that it would not have prevented me from serving on the board.

My association's financial resources, which appear to be large in relation to those available for a majority of California CID associations, do not help the association comply with the Act. The association consults legal professionals often and for a while engaged a professional management firm, but that did not prevent it from having its corporate powers suspended upon coming into force of the penalty provision of Civil Code § 1363.6(d) and from remaining in the "suspended" status for almost two years. The board and the staff remained unaware of the suspension for over twenty month--until its accidental discovery (the association was plain lucky that nobody dared to take advantage of the suspension).

I had hoped that the enactment of Assembly Bill 567 (Saldaña) would increase the visibility of the Davis-Stirling Act through the Civil Code § 1380.230 proposed in the bill and the Common Interest Development Bureau fee. I have been disappointed by the Governor's decision to veto the bill, and more so by the decision of you and your colleagues to recommend "against any efforts to reintroduce this proposal at this time." Memorandum 2008-44, p. 2.

CID associations continue to be left to be run by "volunteer directors who may have little or no prior experience in managing real property, operating a nonprofit association or corporation, complying with the law governing common interest developments, and interpreting and enforcing restrictions and rules imposed by the governing documents . . . ," and numerous California homeowners are left without a full understanding of "their rights and obligations under the law and the governing documents." See proposed Civil Code § 1380.100 (b). Please make it sure that your efforts to make life easier for small associations not inadvertently deprive their members of the protection accorded by the governance provisions of the Davis-Stirling Act, of which many members are unlikely to be fully aware; it would not be nice to remove their protection before they know that it exists.

<u>Existing Election Procedure</u>

Memorandum 2009-14 refers on pp. 7-8 to various complaints and concerns about the election procedure mandated by Civil Code § 1363.03. These problems are not limited to small associations, either. The concern that the signature on the outer envelope for ballot delivery may create the risk of identity theft, for example, is a problem unrelated to the size of an association. I would appreciate it if you would

review Civil Code § 1363.03 in a separate study (I have a lot to say based on my experience).

Measure of the Size of Associations

I do not believe that it is appropriate to use one measure for all purposes in defining "small" associations. The use of one single measure for all purposes is similar to the one-size-fits-all approach which you question.

In certain contexts, e.g., the regulations of fiscal matters in Civil Code § 1365 *et seq.*, the magnitude of the aggregate financial resources which associations manage should be taken into consideration. An association which annually collects USD 5 million would have to be subjected to a higher degree of scrutiny in its financial management than an association which collects USD 50,000 a year for many reasons, including the higher risk of carelessness in handling money associated with the availability of large amount of funds ("We deal with an aggregate annual expenditure of USD 5 million. Don't tell us to verify every invoice of USD 1,000 or less!").

And, yes, the financial threshold, if it is to be introduced, should be defined in terms of real, rather than nominal, dollars. The problem you note in the paragraph commencing at the bottom of p. 2, with reference to the USD 75,000 in Civil Code § 1365(c), is a problem of faulty drafting, and is not a good reason for recommending against a revenue-based (or expenditure-based or asset-based) definition. Each threshold financial amount should be defined so as to provide for its automatic adjustments based on an appropriate price index. This would raise the question of what the most appropriate price index is. No problem; there are more than enough economists in California who can advise you on the question.

I wish to draw your attention to another possible measure which Memorandum 2009-14 does not consider but which may be more appropriate in some contexts: the number of members. For example, elections by secret ballot would make very little sense when an association has only two members, regardless of the number of units and the amount of revenue the association collects annually.

The number of members differs from the number of units in all residential CIDs I know because many members own multiple units: there are many residences comprising physically merged multiple units which remain legally separate, while a considerable number of members who own physically separate multiple units lease or otherwise offer some of their unit for use by non-members, e.g., their family members and friends. An association which manages a 100-unit project

could have 25 members or less. Your argument in favor of the use of the number of units in the third full paragraph of p. 3 works better for the use of the number of members than for the use of the number of units. The number of members is less stable than the number of units. But an association which keeps its member list current, as it should, would have no trouble finding the number of its members on short notice.

If I remember correctly, the Davis-Stirling Act has yet to define the term "member." In case you are reluctant to introduce an undefined term into this study, please recall that "member" appears frequently in the Act.

I look forward to further discussions of special procedures for small associations.

Sincerely,

Kazuko K. Artus

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February 9, 2009

Via E-Mail and U.S. Mail

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

Attention: Brian Hebert, Executive Secretary

Re: Common Interest Developments (Small Homeowner Associations)
CLRC Study H-857, Memorandum 2009-14 and First Supplement

Dear Mr. Hebert:

I am in receipt of the Commission's Memorandum 2009-14 and its First Supplement. The Board of Directors of the Grassy Run Homeowners' Association (GRHA) has authorized me, as a former Vice President and Director, to present to the Commission, on the Board's behalf, the following views. The context of these views is as follows:

Description of the Association

GRHA is an entity consisting of 89 five-acre parcels located in El Dorado County approximately halfway between Shingle Springs and Placerville. Its annual dues are presently set at $300 per year per parcel, or a total of less than $30,000 annually. Almost all the income from those dues is used to maintain a system of private roads, total length of approximately five (5) miles, which meander through the community. Because GRHA is located immediately adjacent to an Indian Rancheria on which a Casino has just recently been opened, there is considerable discussion within the community about installing a system of gates to limit entry to GRHA members or their invitees into the road system. Such a project would require a special assessment, but GRHA has never previously imposed any special assessments.

GRHA's dues were raised to $300 per year in December 2006. Previously, for many years, they had been set at $150 per year per parcel. The demographics of the Grassy Run community are mixed. We have members of African-

American, Hispanic and Asian, as well as Caucasian, ancestry. We also have members whose income varies from barely above poverty levels to six-figure levels. As with many communities, we have had approximately ten percent (10%) of our parcels go into foreclosure within the last year. We have had to adopt a monthly payment-plan procedure because some of our members cannot afford to pay even $300 at one time in a lump sum. In short, we are not a community whose members all can afford, on an ongoing basis, much more than our present level of dues. We do not have, and cannot afford to employ, a manager or management service, or other professionals (such as accountants or attorneys specializing in the law applicable to common interest developments [CIDs}), and still be able to devote the bulk of our modest income to our very reason for existence, road maintenance.

GRHA does not own any common areas as that term is usually defined. We are a common interest development solely because of our members' mutual reciprocal easements over the Grassy Run road system, which is constructed on land owned by the members and not by the association, and because of the provisions of Section 1351, subsections (b) [second sentence] and (k)(2), of the Civil Code.

GRHA's Essential Position

I wrote to you on July 26, 2008, commenting on the Commission's study concerning statutory clarification and implementation of CID law. I indicated, at that time,

> "the view of my Association, and I suspect of many other associations similarly situated, that for small associations (measured either by number of units [under 100] or by income in relation to size [under $1,000 per unit]), the requirements of the Davis-Sterling Common Interest Development Act [the Act] are already too detailed, cumbersome and intrusive.

I suggested that "there should be consideration given to something like a "Davis-Sterling Lite," with many if not most of the requirements of the Act either deleted entirely or made elective as to small associations." I pointed out that "everything that requires the expenditure by associations of money for administrative purposes is something that detracts from the very purpose of the associations' existence, i.e., community benefit."

I also observed that "the Act is written (and likely must be written, given the minutiae of its requirements) in a manner that is frequently difficult for me,

as an attorney with more than 45 years litigation experience as a member of the Bar, to understand; it was absolutely incomprehensible to most, if not all, of my former Board colleagues. And I hasten to add that they were not dumb people! In essence, the Act seems to be written to benefit experts and professionals much more than the lay people who have to try to comply with it. And that disconnect means, as a practical matter, that small associations will tend to go on their merry ways and completely ignore the Act because they can't afford to hire experts and professionals to do otherwise!"

I suggested that for laymen trying to function under the Act, it was like asking them to read and interpret the Internal Revenue Code! I also noted that, notwithstanding the "public policy supportive of the existence of homeowners' associations," the "ever increasing and onerous duties and obligations on the part of officers and directors of such associations are counter-productive to the existence of such associations. Non-professional officers and directors, after all, are volunteers." I asked: "Who in their right mind is going to volunteer for the grief that ever increasing and onerous duties and obligations lead to?"

You responded to me by indicating that the "idea of a simplified governance procedures for small associations is a top contender for the next project." Now that that project has come to fruition, I am submitting this letter in support of Project H-857, but with views that both concur with and contradict the views of some of your previous correspondents.

Other Public Comments

The First Supplement to Memorandum 2009-14 gives evidence that GRHA is not alone in its concerns. All of the correspondents, and I, are "supportive of the goals study." Each of the correspondents, however, appears to come from different sets of experiences.[1] Not surprisingly, then, various recommendations from those correspondents are sometimes in tension with each other with regard to the definition of a "small association."

Specifically, some of the commenters support a definition based on the number of units in a development. Some (including the staff's initial suggestion) set that number at 25. Others propose that it be set at 50, and still others at 100. If the number of units in a development is to be the sole criterion, GRHA would

[1] It appears that the posture of GRHA is most similar to that of the Association discussed by Stephen Dyer, and GRHA is in considerable agreement with many of Mr. Dyer's comments.

support the latter number. But GRHA does not believe that "number of units" should be the sole criterion.

Other commenters support a definition based on annual revenue, either in total or on a per-unit basis. The figure $125,000 has been discussed. GRHA would not have a problem with that figure if a revenue-level test were to be the sole criterion, provided that the "annual revenue" refers to annual dues and assessments and does not include special, i.e. one-time, assessments for special one-time purposes. But again, just as with the "number of units" test, GRHA does not believe that "annual-revenue-level" should be the sole criterion.

GRHA believes that an "either-or" criterion would be the most appropriate, in that it would provide the directors and officers of CIDs with the greatest degree of flexibility in seeking to qualify for "small association" status. An association should qualify as "small" is it meets either the size or income criteria. It is important to remember the fact pointed out by several of the commenters, that it is becoming increasingly difficult to find volunteers who are willing to act on behalf of associations because of the increasing demands being statutorily placed upon them, putting them "between a rock and a hard place" in terms of the non-fit between financial ability and legal obligation. The analogy to "killing the goose [the individual volunteers] that laid the golden eggs [actually attempted to perform incompatible duties]" comes to mind!

You have indicated that the suggestions of Messrs. Dyer and Gorfinkel that special treatment for specified types of associations, based upon their limited duties and functions, "are beyond the scope of the current study, which is limited to consideration of distinctions based on *size*, rather than *type*." With respect, however, I do not believe that one can talk about size in a vacuum, without considering what it is that an entity of a given size is tasked with, and the economic or financial ability of that entity to perform that/those task[s]. For example, a domestic housecat may be too big to fit through the eye of a needle, but it is not nearly big enough to haul a beer-wagon!

Considering size without also considering the nature and extent of duties is, in my view, merely a subset of the unfortunate "one size fits all" concept that has led the Commission to Project H-857 in the first place. The definition of "size" should constitute the beginning, not the end, of the inquiry to which this project is addressed. Should the definition of "small" consider only questions of number of units and/or income, or should it also consider the breadth and extent (or lack thereof) of the purposes and the substantive duties and responsibilities imposed upon particular types of associations? What should be the differences between the duties and responsibilities of "small" associations rather than

"large" ones, and should those duties and responsibilities vary according to the purposes of the association? For example, it seems to me that the proposed "road maintenance association" study might profitably be combined with this current "association size" study.

Similarly, the "graduated system of accounting requirements" proposed by Messrs. Dolnick and Haney, and simplification of the "professional reserve study" requirement as proposed by Mr. Dyer, are further examples of issues that are, in my view, inextricably intertwined with the bare issue of size, for the same reasons discussed in the previous paragraphs. If the money isn't there to pay for "something," what is the point of having a statutory requirement that that "something" be done?

On behalf of GRHA, I respectfully request that the Commission consider the foregoing thoughts in its deliberations with regard to Project H-857. We thank you for the opportunity to submit our views on the project.

Very truly yours,

Richard W. Nichols

cc: Brian Hebert
California Law Revision Commission
3200 5th Ave
Sacramento, CA 95817

Walnut House Cooperative
1740 Walnut Street
Berkeley, California 94709

February 10, 2009

California Law Revision Commission
Attn: Brian Hebert and Steve Cohen (via email)

Re: Comments on Memorandum 2009-14

Dear Brian, Steve and Commissioners:

We appreciate the Commission development of proposed legislation for small associations. We support this approach, which will unburden many of us from overly demanding procedures. Please refer to our previous public comments for information about cooperatives and cohousing communities. We are pleased to submit our comments about the staff's proposed simplified election procedures.

Defining a "small association"

We support defining a small association based on the number units, rather than budget size. Housing cooperative budgets have attributes different from many non-cooperatives. First, a co-op may or may not have a blanket mortgage. The monthly repayment of it is included in the monthly assessment. The amount of such a mortgage may vary based on unit size/value, age of the building, interest rate, term, etc. Also, the reserve contributions may vary based on the condition and/or age of the structures. So–unlike other associations–the monthly assessment per unit could vary widely between cooperatives of the same size. Thus, it would not be fair to use the annual budget to define a "small" housing cooperative.

We suggest that the Commission be open to the possibility of using different association sizes for different "small association" issues, although we have not studied the matter. However, if a single size is used, we would like to see it set at fifty units. This size would include all known cohousing communities in California and many limited-equity housing cooperatives. For your reference, the City of Berkeley's definition of cohousing can be found at:

http://www.ci.berkeley.ca.us/bmc/Berkeley_Municipal_Code/Title_21/28/030.html .

Many associations under this size (as well as all known cohousing developments in California) are self-managed, where many members participate with each other in the operation of their communities. Because of this, there is a significant amount of social interaction and community-building and thus less reason to require more formal election procedures. Our cooperative is self-managed. Also, most or all known cohousing communities in California use a modified

form of consensus. Further, there are cooperatives with more than twenty-five units that use consensus. Because of the potential for greater community when using consensus, these associations should have the option of being treated as small associations.

Proxies

Existing law requires that a proxy may only be given to another member. Our governing documents also permit granting a proxy to a member's sublessee. They also provide that each individual with the right to cast a vote may only cast a single vote, to prevent the accumulation of too much voting power in one person. For example, a sublessee may hold a proxy and cast a vote; one person of a two-person membership may cast a vote for that membership and the other person may hold and vote a proxy. We would support loosening restrictions on who can hold a proxy. Allowing a sublessee to hold a proxy would make it easier for us to produce a quorum while preventing the accumulation of voting power in individual members. As a sublessee in our cooperative must go through the same screening process as a member, the sublessee would have more interest and knowledge of the cooperative than perhaps a tenant in another type of association.

Secrecy

Many cohousing communities and small limited-equity housing co-ops use collaborative forms of decision-making, such as modified forms of consensus. While voter secrecy should be available if desired, a small association should have the ability–if all agree–to use non-secretive voting procedures. This would simplify and speed decisions while protecting the rights of a member wishing to preserve the secrecy of one's vote.

In-person voting

We support the idea of in-person voting and would make the following changes to the memorandum's proposals:

The thirty-day notice of election may be too long for a small association and should be governed by an association's governing documents, provided that it is reasonable. Ours is ten days.

The quorum definition in 1368.08(a)(2) should defer to an association's governing documents. For example, we compute a quorum based on only those natural persons with the right to vote. So only one member of a multi-person membership would count toward a quorum. If the other person held a proxy, however, the other person would also count. A sublessee holding a proxy would also count. This conflicts with the proposed section.

If permitted by an association's governing documents and agreed to by all members at a meeting, voting should be permitted to take place without a secret ballot (e.g. by a show of hands). Please see the previous discussion about secrecy.

An association should provide written procedures for breaking a tie. The suggested provision in 1368.08(a)(6) should only apply if there were no method to break a tie in an association's

election procedure. Our procedure calls for an additional round of voting followed by a drawing of lots. The use of first-past-the-post elections should not be assumed by the statute. Our cooperative governing documents require a 2/3 supermajority of all members to elect a board member. They also provide for runoff rounds to attempt to fill all vacant board seats.

Voting outside of a meeting

In lieu of requiring mail-in ballot elections, small associations should be permitted to receive ballots into a sealed or locked receptacle under the custody of the elections inspector. The thirty-day nomination and balloting periods should only be required if requested by a member (e.g. if a member were to travel). Otherwise the periods set forth in an association's governing documents should apply.

Write-in candidates

One commentator wrote about write-in candidates. We do not think the statute should require the counting of unwilling write-in candidates, but should rather permit counting such votes if consistent with an association's governing documents. In our case, a candidate must accept their nomination in order for their votes to count. Allowing the counting of unwilling write-in candidates would complicate our runoff procedures.

Except as provided above, we support the proposals set forth in the staff's memorandum. Thank you for your efforts, which are greatly appreciated. We urge the Commission to move forward with the development of these proposals. Please feel free to contact me if you have questions or require further information. Thank you for your consideration.

Very truly yours,

Bob Sheppard, Legislative Coordinator
Walnut House Cooperative

Contact: 510.644.2463