Study H-856 April 10, 2009

Memorandum 2009-18

Common Interest Development Law: Nonresidential Associations (Discussion of Issues)

In this study, the Commission is considering which provisions of the Davis-Stirling Common Interest Development Act (Civ. Code §§ 1350-1378) (hereafter "Davis-Stirling Act") should apply to a nonresidential common interest development ("CID"). The study would expand on existing Civil Code Section 1373, which presently exempts nonresidential CIDs from nine specified provisions of the act.

The overall goal of the study is to exempt nonresidential CIDs from those provisions of the act that primarily relate to and benefit only homeowners, and are unnecessary and burdensome when applied to nonresidential owners.

The study is conducted pursuant to the Commission's current authorizing resolution, which directs and authorizes the Commission to study:

> Whether the law governing common interest housing developments should be revised to clarify the law, eliminate unnecessary or obsolete provisions, consolidate existing statutes in one place in the codes, establish a clear, consistent, and unified policy with regard to formation and management of these developments and transaction of real property interests located within them, and to determine to what extent they should be subject to regulation.

2007 Cal. Stat. res. ch. 100.

The following materials are attached as an Exhibit:

METHODOLOGY

The staff will analyze the applicability of the provisions of the Davis-Stirling Act to nonresidential CIDs in three general steps:

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

(1) *An analysis of the provisions listed in Section 1373.* The policy choices made by the Legislature with regard to the provisions listed in Section 1373 should be given some deference, in the absence of a change in circumstances, or some other significant countervailing consideration.

(2) *Extrapolation from the decisions made about Section 1373.* The staff will determine whether any provision listed in Section 1373 is substantially similar to other provisions in the Davis-Stirling Act. If so, it may be appropriate to extend whatever decision the Commission makes about the provision in Section 1373 to the similar provision.

(3) *An analysis of the remaining provisions of the Davis-Stirling Act.* The provisions of the Davis-Stirling Act that cannot be analyzed in the first two steps will be analyzed based on a consideration of factors that the Legislature has identified as relevant on this issue, on other appropriate policies that become evident in the course of the study, and on public input on the realities of ownership in a nonresidential CID.

This memorandum proceeds through the first step described above — an analysis of the provisions listed in Section 1373. Future memoranda will undertake the next two steps.

Future memoranda will also discuss the following questions, which the Commission has decided to hold for consideration until after it has made preliminary decisions as to each provision of the Davis-Stirling Act:

- What "default" rule should govern provisions that are added to the Davis-Stirling Act in the future, when the Legislature does not expressly indicate whether the provision is intended to apply to a nonresidential CID?
- How should the proposed law treat "mixed use" CIDs (i.e., CIDs that contain both residential and nonresidential units)?
- Should the proposed law include a new statutory definition of "nonresidential CID"?

BACKGROUND ON SECTION 1373

The Legislature first exempted nonresidential CIDs from provisions of the Davis-Stirling Act in 1988, by enacting Civil Code Section 1373. See 1988 Cal. Stat. ch. 123. The legislative history underlying this enactment may be helpful in understanding the rationale for these exemptions.

Origin of Section 1373

The Davis-Stirling Act as enacted applied to both residential and nonresidential CIDs. See 1985 Cal. Stat. ch. 874 (Civ. Code § 1352). Legislative history, however, suggests that the application of the act to nonresidential CIDs may have been an oversight, rather than an intentional policy choice. See discussion in CLRC Memorandum 2008-63, pp. 3-4.

Three years later, in an apparent attempt to cure that oversight, the Legislature enacted AB 2484, which added Civil Code Section 1373 to the Davis-Stirling Act. See 1988 Cal. Stat. ch. 123 (AB 2484 (Hauser)).

As introduced, AB 2484 would have made the entire Davis-Stirling Act inapplicable to nonresidential CIDs. See discussion in CLRC Memorandum 2008-63, pp. 3-4.

After the bill's introduction, however, a letter relating to the bill was sent to its author by a committee of the Northern California Building Industry Association (hereafter, "NCBIA"). NCBIA expressed opposition to exempting nonresidential CIDs from all provisions of the act, asserting that some provisions were helpful to nonresidential CIDs. See CLRC Memorandum 2008-63, Exhibit pp. 1-2.

NCBIA requested that the bill instead be amended to exempt nonresidential CIDs from only seven specifically identified provisions of the act. All other provisions of the Davis-Stirling Act would continue to apply. *Id.* AB 2484 was thereafter amended as proposed by NCBIA, and Section 1373 was enacted in that amended form.

Legislative Committee Analysis

An analysis of AB 2484 by the Senate Rules Committee in 1988 identifies various arguments supporting enactment of Section 1373:

- Nonresidential CIDs are "business endeavors in which the parties engage the services of attorneys, accountants, management companies, and developers."
- Unlike owners in residential CIDs, owners in nonresidential CIDs are "well-informed" and "governed by other provisions of commercial law."
- The operational needs of nonresidential CIDs are different than the needs of residential CIDs. For example, (1) diverse businesses in a nonresidential CID may require disproportionate assessments, and (2) nonresidential CIDs frequently add amenities that require

timely increased assessments, but which owners in nonresidential CIDs can pass on to their customers.

- Regulatory requirements designed to protect residential owners "interfere with commerce, and increase the costs of doing business."

Exhibit pp. 2-3.

The Legislature further explained its rationale for enacting Section 1373 within the text of the section:

> The Legislature finds that the provisions [listed in Section 1373] are appropriate to protect purchasers in residential common interest developments, however, the provisions may not be necessary to protect purchasers in commercial or industrial developments since the application of those provisions could result in unnecessary burdens and costs for these types of developments.

Civ. Code § 1373(b).

Criticism of "Sophistication" Rationale

One rationale for the enactment of Section 1373 might be summarized as follows: The typical owner in a nonresidential CID can be expected to have significantly more sophistication about business matters than the typical owner in a residential development. Therefore, a nonresidential owner should generally need less regulatory protection than a CID homeowner as to matters relating to the operation and governance of their CID.

That argument does seem logical. One might expect business property owners as a group to be more familiar than a group of homeowners with long term financial planning, contractual obligations, principles of corporate governance, etc., and thus less in need of regulation in those areas.

However, not all commenters on this study agree.

Don Haney, an accountant in Roseville who has provided accounting services for CIDs for many years, submitted the following comment to the Commission in January, 2009:

> The common basis for exempting commercial CIDs from a number of Davis-Stirling Act (the Act) provisions is the anecdotal notion that owners and directors in these communities are more sophisticated and do not need the consumer protection provisions imbedded in the Act. I am unaware of any research that validates this postulate.
>
> Our firm has been involved with a number of different commercial CIDs over the years. I can assert without reservation

> that these owners and their directors are no more sophisticated in their awareness of CID operational, finance and governance issues than their residential counterparts. In fact, one could make the case that they are less functional than their residential counterparts at maintaining their facilities, financing the operation, governing and informing new buyers about their situation just because they are exempt from some of the compliance requirements.
>
> If I were responsible for the decision, I would not exempt commercial CIDs from any statutory compliance duties.

First Supplement to CLRC Memorandum 2009-14, Exhibit p. 10.

Tina Rasnow, a former coordinator with the Ventura County Superior Court Self-Help Legal Access Center, made a somewhat similar comment in December, 2008, responding to the introduction to this study:

> While it is true that many provisions of Davis-Stirling are particularly directed to homeowners, I think consumer protection needs to be in place for non-residential CID's because many are owned by sole proprietors and small business owners who do not have the expertise or bargaining power that large businesses have. The fact that they may be set up as corporations or LLC's does not necessarily mean they have legal counsel or sophistication. Unfortunately, many small business owners fall prey to the seminars and websites promising personal immunity or protection from lawsuits by incorporating, when in fact they function for all intents and purposes, as a dba. We see them regularly in our self-help center at the court when they get embroiled in a dispute and we explain that because of their corporate status they must be represented by an attorney, yet they do not have the money to hire one.
>
> The eleven years I have run the Self-Help Legal Access (SHLA) Center at the Ventura Superior Court has caused me to rethink many of my previous views about business owners, their access to legal counsel, and their sophistication. They, like many members of the general public, are easy victims of scam artists looking to get rich by selling false promises, and with legal costs such as they are, many are simply unable to afford good legal counsel which they desperately need.
>
> I think it is important to get input from small business owners who own office condos, perhaps through the Chambers of Commerce, or other small business groups, or from attorneys who represent the small business owner, to determine what types of protections need to be in place for this population. I would be reluctant to gut existing protections, without having some alternative in place.

First Supplement to CLRC Memorandum 2008-63, Exhibit p. 4.

On the other hand, Karen Conlon, the president of the California Association of Community Managers (CACM), submitted the following comment to the Commission in March, 2007, in support of an exemption for nonresidential CIDs from the voting provisions of the Davis-Stirling Act:

> The following two demographic facts differentiate the purchaser of a commercial building or unit from the purchaser of a residence:
>
> (1) Approximately 90% of the owners who purchase buildings or commercial units in the associations own them as a corporation, LLC, trust or partnership. Almost all of these, whether they are owned as noted above or as individuals/joint tenants, own and operate an incorporated business within the building or unit. These parties are sophisticated. They have hired legal counsel to form their legal entities and have the legal and financial resources to hire legal counsel when they believe it appropriate to protect their interests.
>
> (2) The typical purchase price, represented as the middle 70% of the building or units sold today, varies between $1,000,000 - $4,000,000. The purchase and sale of these buildings and units are typically facilitated by one or more attorneys, who are obligated to protect the interests of their clients through the diligence process.
>
> In summary, these are parties who have the sophistication to manage businesses, take advantage of legal and tax opportunities presented to such businesses and to purchase multi-million dollar buildings for the tax and estate benefits provided thereby.

CLRC Memorandum 2008-63, Exhibit p. 4. (The figures cited by Ms. Conlon may no longer be accurate, in light of recent changes in the real estate market.)

Throughout this study, the Commission should keep these comments in mind when considering arguments based on an assumption that nonresidential CID owners in general are more sophisticated about financial and legal matters than CID homeowners in general.

The staff encourages further comment on this issue from interested persons.

PROVISIONS LISTED IN SECTION 1373

The full text of each provision listed in Section 1373 is provided at Exhibit pages 4-30. As originally enacted, seven different provisions were listed. Two others were added later. The seven original provisions are analyzed first, then the two later additions.

Civ. Code § 1356. Judicial Relief to Allow Amendment of Declaration

The first provision listed in Section 1373 is Civil Code Section 1356. Civil Code Section 1373(a)(1) makes Civil Code Section 1356 inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1356 provides a procedure for an owner or a CID association, in special circumstances, to petition a court to approve and enforce a proposed amendment to a CID declaration.

A declaration is the founding document of a CID, typically setting out the rules, restrictions, and rights governing the CID and its owners. Once recorded, the terms and restrictions in the declaration become binding equitable servitudes on all persons who own or later acquire a separate interest in the development. See Civ. Code § 1354.

Some declarations provide that the declaration may not be amended without the approval of a supermajority of the voting power of the association (i.e., a specified percentage greater than a majority, such as 75%).

This kind of requirement can sometimes prove problematic. Years after recordation, an amendment to the declaration could be needed to allow the association to adjust to new and uncontemplated circumstances. The existence of the supermajority voting requirement, however, combined with a sufficient degree of voter apathy, may prevent the association from being able to pass the needed amendment.

Section 1356 provides a solution to this problem, by providing an association or its owners an opportunity to obtain judicial relief from a supermajority vote requirement. Relief under the section is available only upon a showing that a proposed amendment has already been approved by at least 50% of the association's voting power. The petitioner must further establish that the proposed amendment is reasonable, and must meet other substantive and procedural requirements. The granting of the petition remains a discretionary decision for the court.

Given that the seeking of relief under this section is optional, it is not immediately apparent why the Legislature chose to exempt nonresidential CIDs from application of Section 1356.

Substantially Overlapping Provision of Commercial Law

As indicated in the Senate Rules Committee analysis, one rationale for exempting nonresidential CIDs from Section 1356 would be the existence of another provision of law that largely duplicates the provisions of Section 1356.

Most (but not all) nonresidential CIDs are nonprofit mutual benefit corporations, governed by the Nonprofit Mutual Benefit Corporation Law (Corp. Code §§ 7110 to 8910). Throughout this study, this body of law will be the most likely source of provisions governing nonresidential CIDs that overlap or duplicate a provision of the Davis-Stirling Act.

The Nonprofit Mutual Benefit Corporation Law does in fact contain a provision that is similar to Civil Code Section 1356. Corporations Code Section 7515 provides:

> 7515. (a) If for any reason it is impractical or unduly difficult for any corporation to call or conduct a meeting of its members, delegates or directors, or otherwise obtain their consent, *in the manner prescribed by its articles or bylaws, or this part*, then the superior court of the proper county, upon petition of a director, officer, delegate or member, may order that such a meeting be called or that a written ballot or other form of obtaining the vote of members, delegates or directors be authorized, in such a manner as the court finds fair and equitable under the circumstances.
>
> (b) The court shall, in an order issued pursuant to this section, provide for a method of notice reasonably designed to give actual notice to all parties *who would be entitled to notice of a meeting held pursuant to the articles, bylaws and this part*, whether or not the method results in actual notice to every such person, or conforms to the notice requirements that would otherwise apply. In a proceeding under this section the court may determine who the members or directors are.
>
> (c) The order issued pursuant to this section may dispense with any requirement relating to the holding of and voting at meetings or obtaining of votes, including any requirement as to quorums or as to the number or percentage of votes needed for approval, *that would otherwise be imposed by the articles, bylaws, or this part*.
>
> (d) Wherever practical any order issued pursuant to this section shall limit the subject matter of the meetings or other forms of consent authorized to items, including amendments to the articles or bylaws, the resolution of which will or may enable the corporation to continue managing its affairs without further resort to this section; provided, however, that an order under this section may also authorize the obtaining of whatever votes and approvals are necessary for the dissolution, merger, sale of assets or reorganization of the corporation.

> (e) Any meeting or other method of obtaining the vote of members, delegates or directors conducted pursuant to an order issued under this section, and which complies with all the provisions of such order, is for all purposes a valid meeting or vote, as the case may be, and *shall have the same force and effect as if it complied with every requirement imposed by the articles, bylaws, and this part*.

(Emphasis added).

A close examination of the text of this section, however, reveals ambiguity as to whether the section applies when difficulty in obtaining member consent is due to a provision in a CID's *declaration*. The section could be read as providing relief only from restrictive requirements in the CID's corporate *articles* or *bylaws* (which are typically distinct governing documents), or in the Corporations Code.

An older case, *Greenback Townhomes Homeowners Assn. v. Rizan*, 166 Cal. App. 3d 843, 212 Cal. Rptr. 678 (1985), seems to suggest that Section 7515 can be used to provide relief from a requirement in a declaration. In *Greenback Townhomes*, a trial court granted a Section 7515 petition brought by an incorporated CID for relief from a supermajority vote provision in what was referred to as the development's "CC&R's." The decision was upheld on appeal. Nevertheless, two aspects of the decision suggest that the opinion does not resolve whether, at the present time, the relief from a supermajority voting requirement available under Civil Code Section 1356 may be obtained by a nonresidential CID under Corporations Code Section 7515. (The *Greenback Townhomes* opinion has not been cited on this point by any subsequently published appellate decision.)

First, the appeal in *Greenback Townhomes* was brought by an owner whose sole contention on appeal was that the plaintiff that brought the petition had no standing to file the petition. The issue of whether the section authorized the provision of relief from a provision in a declaration, as opposed to a provision in either articles or bylaws, was neither raised by the parties, nor addressed by the appellate court.

Second, the 1985 decision in *Greenback Townhomes* was rendered prior to the enactment of Civil Code Section 1356. As Section 1356 was patterned after Corporations Code Section 7515 and addresses a more specific situation (see *Blue Lagoon Community Assn. v. Mitchell*, 55 Cal. App. 4th 472, 64 Cal. Rptr. 2d 81 (1997)), a strong argument can be made that the Legislature now intends relief from a voting provision in a CID declaration to be governed by Civil Code

Section 1356, while Corporations Code Section 7515 is intended to address relief from a provision in a nonprofit corporation's corporate articles or bylaws.

That was the approach taken by petitioning CID owners in the recent case of *Fourth La Costa Condominium Owners Ass'n v. Seith*, 159 Cal. App. 4th 563, 71 Cal. Rptr. 3d 299 (2008). In that case, an incorporated CID seeking relief from voting requirements in its bylaws and in its declaration filed petitions under *both* Corporations Code Section 7515 and Civil Code Section 1356, a procedure that the appellate court tacitly acknowledged was appropriate.

Although a degree of uncertainty exists, it is the staff's conclusion that Corporation Code Section 7515 does not provide an adequate alternative for an incorporated nonresidential CID seeking the relief provided by Civil Code Section 1356.

Further, Corporations Code Section 7515 does not apply to and clearly offers no remedy to an *unincorporated* nonresidential CID. Such entities are not governed by the Nonprofit Mutual Benefit Corporation Law.

Rather than relying on Corporations Code Section 7515, there might be two other ways for owners in a nonresidential CID to address a problematic provision in a declaration. Instead of attempting to amend the declaration, they could attempt to have the undesired provision declared unenforceable, under either Civil Code Section 1354 or under the common law. However, neither of these theories appears to be a complete substitute for the remedy available under Section 1356.

Section 1354 provides that covenants and restrictions in a recorded declaration are enforceable equitable servitudes, "unless unreasonable." The Supreme Court has set this "unless unreasonable" threshold relatively high:

> When … a restriction is contained in the declaration of the common interest development and is recorded with the county recorder, the restriction is presumed to be reasonable and will be enforced uniformly against all residents of the common interest development *unless the restriction is arbitrary, imposes burdens on the use of lands it affects that substantially outweigh the restriction's benefits to the development's residents, or violates a fundamental public policy*.

Nahrstedt v. Lakeside Village Condominium Assn., 8 Cal. 4th 361, 386, 878 P. 2d 1275 (1994) (emphasis added).

Plaintiffs who have brought challenges to equitable servitudes under the common law based on changed conditions have faced a similar hurdle:

> A court will declare deed restrictions to be unenforceable when, by reason of changed conditions, enforcement of the restrictions *would be inequitable and oppressive, and would harass plaintiff without benefiting the adjoining owners*. …. A building restriction in the nature of a servitude will not be enforced where changed conditions in the neighborhood have *rendered the purpose of the restrictions obsolete. But, if the original purpose of the covenant can still be realized, it will be enforced even though the unrestricted use of the property would be more profitable to its owner*."

Bolotin v. Rindge, 230 Cal. App. 2d 741, 743-44, 41 Cal. Rptr. 376 (1964) (internal citations omitted).

Neither of these remedies would appear to provide the same relief as that available under Section 1356, because the standard for granting relief under either is much stricter than under Section 1356. Relief under Section 1356, although discretionary, requires only that a proposed amendment be "reasonable," and not interfere with the rights of special class voters, the developer, and any mortgagee or beneficiary of a deed of trust.

Considerations Specific to a Nonresidential CID

The Legislature's decision to make Section 1356 inapplicable to nonresidential CIDs may have been based on its conclusion about the relative business sophistication of owners in nonresidential CIDs. The Legislature may have felt that, on balance, the protection available under Section 1356 was not needed by nonresidential owners, or in any event outweighed by a more significant potential downside that might result from making the section applicable to nonresidential CIDs.

What is that downside? Section 1356 can permit a majority of owners in a CID to circumvent a supermajority voting requirement, even when a significant minority of owners want the supermajority requirement enforced, and may have expressly *relied* on the existence of the supermajority requirement when purchasing an interest in the CID.

For example, an owner purchasing an interest in a nonresidential CID with such a requirement may have formulated a long term business plan based on an expectation that assessment increases would be limited as set forth in the recorded declaration, except upon a supermajority vote to the contrary. Alternatively, an owner may have relied on an expectation that only those

business uses permitted by the declaration would be allowed in the future, unless a supermajority of the development voted otherwise.

This is a relatively compelling justification for this exemption. Businesses that enter into arms-length transactions should not be lightly deprived of the benefit of their bargain, except in extremely compelling circumstances. And while Section 1356 does not allow a court unfettered discretion to override a supermajority voting requirement, it does allow a court to do so in the face of minority opposition.

Still, there may be cases where a proposed amendment to a nonresidential CID declaration has *no* opposition, yet cannot be passed due to an impractically high supermajority approval requirement. On this point, it is notable that the Legislature has provided incorporated nonresidential CIDs with an opportunity to judicially bypass a supermajority voting provision contained in its corporate articles or bylaws. See Corp. Code § 7515, discussed previously. Why deny nonresidential CIDs the same flexibility with regard to an amendment of their declaration?

Recommendation

Strong arguments can be made both for and against the applicability of Section 1356 to nonresidential CIDs.

On the one hand, keeping the section inapplicable to nonresidential CIDs would preserve the benefit of the bargain for sophisticated business property owners who carefully considered the declaration before purchasing an interest in a CID, and relied on its terms (including any supermajority approval requirement) in making the decision to purchase. Further, the Legislature expressly decided to make Section 1356 inapplicable to a nonresidential CID. That legislative policy choice, which to the staff's knowledge has not caused any obvious problems or complaints in 20 years, deserves some deference.

On the other hand, making Section 1356 applicable to nonresidential CIDs would provide flexibility to adjust to changing circumstances. Absent Section 1356, voter apathy can be a significant impediment to necessary change. Further, the Legislature has already provided an incorporated nonresidential CID with a similar procedure to override a supermajority requirement in its articles or bylaws. It isn't clear why a CID declaration should be treated differently. (Presumably, sophisticated business owners also carefully consider and rely on

corporate articles and bylaws when deciding whether to purchase property in a nonresidential CID that is incorporated.)

Ultimately, while the staff views the question as close, it is not clear that the case for making Section 1356 applicable to a nonresidential CID is strong enough to justify overriding the Legislature's decision on the issue. **Unless further information or argument on this issue is offered by stakeholders, the staff would defer to the Legislature and leave Section 1356 inapplicable to nonresidential CIDs.**

Civ. Code § 1365. Annual Budget and Reports

Another provision originally listed in Civil Code Section 1373 is Civil Code Section 1365. Civil Code Section 1373(a)(4) makes Civil Code Section 1365 inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1365 requires a CID association to prepare and distribute to all owners an annual pro forma operating budget, detailed reserve information, estimated replacement costs for major components of the development, insurance disclosures, and various other financial information. The section further mandates a financial review by a licensed accountant, according to generally accepted accounting principles, in every CID in which gross revenue to the association exceeds $75,000 annually.

Substantially Overlapping Provision of Commercial Law

Two provisions in the Nonprofit Mutual Benefit Corporation Law require an incorporated residential CID to maintain or provide to its members financial information similar to that required to be maintained and provided by Civil Code Section 1365.

Corporations Code Section 8320 requires a nonprofit mutual benefit corporation to keep "adequate and correct books and records of account." Corporations Code Section 8321 requires such a corporation — except one that receives less than $10,000 in gross revenues or receipts in a fiscal year — to provide each of its members with the corporation's most recent annual report. This annual report is to contain a balance sheet, an income statement, and a statement of cashflows for that fiscal year, accompanied by supporting documentation.

These two provisions, considered together, appear to substantially overlap the requirements of Civil Code Section 1365.

Considerations Specific to a Nonresidential CID

In addition, it is likely the Legislature based its exemption of nonresidential CIDs from Section 1365 on a conclusion that the business owners in a nonresidential CID will generally be capable of obtaining on their own whatever financial information they need relating to their CID, and do not need the potentially costly "one size fits all" regulation imposed by Section 1365.

It is possible that a nonresidential owner might desire information that (1) is not required to be maintained or provided by Corporations Code Sections 8320 or 8321, (2) is not independently maintained or provided by the CID, and (3) is not otherwise readily obtainable by the owner, but (4) is required to be provided under Civil Code Section 1365. However, that seemingly remote possibility does not provide sufficient justification to overrule the Legislature's determination that the application of Section 1365 to nonresidential CIDs would be unduly burdensome to nonresidential CIDs in general. See Civ. Code § 1373(b).

Recommendation

Unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that Section 1365 continue to be inapplicable to a nonresidential CID.**

Civ. Code § 1368. Seller Disclosures

Another provision originally listed in Civil Code Section 1373 is Civil Code Section 1368. Civil Code Section 1373(a)(8) makes Civil Code Section 1368 inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1368 requires an owner in a CID to provide various documents to a prospective purchaser of the owner's separate interest in the CID. The documents generally relate to rules governing operation of the CID, the financial structure and stability of the CID, and the physical integrity of the CID. The section also requires the association to make copies of the documents available to a requesting owner for a reasonable fee, and generally prohibits a CID from assessing a fee in connection with a transfer of title, except as specified. A person

or entity that willfully violates the section is liable for damages, a civil penalty, and attorney's fees.

Overlapping Provision of Commercial Law

A seller of commercial property has a duty to disclose to a prospective buyer facts that materially affect the value of the property, which are known or accessible to the seller, and are not reasonably known to the buyer. *Stevenson v. Baum*, 65 Cal. App. 4th 159, 165, 75 Cal. Rptr. 2d 904 (1998), *Reed v. King*, 145 Cal. App. 3d 261, 266, 193 Cal. Rptr. 130 (1983). However, this common law obligation may not completely overlap the statutory disclosure requirements in Section 1368.

The common law duty requires a seller only to disclose information that (1) a prospective purchaser doesn't have constructive knowledge of, and (2) a jury would likely conclude has a material effect on the value of the transferred property. While some of the items listed in Section 1368 may satisfy those requirements in a particular case, many others will not.

Section 1368 also provides a prospective buyer with both specificity and certainty as to information that will be provided prior to purchase, and provides a buyer with statutory authority to demand that the seller provide the described information, prior to purchase. A buyer protected only by the seller's common law obligation to disclose has no statutory basis to demand advance disclosure of any specific information.

Finally, a buyer protected by Section 1368 who is harmed because a seller failed to provide listed information (and because the buyer, likely unaware of Section 1368, failed to ask for the information) has a relatively straightforward cause of action for relief. A buyer harmed because a seller breached an obligation to provide material information will in many cases never realize a cause of action exists, because the buyer will never find out about the nondisclosed information. And if the buyer does, the buyer will then have to prove that the seller was aware of the information, prior to the sale.

The staff is unaware of any other provision of commercial law that substantially duplicates Section 1368.

Differing Needs of a Nonresidential CID

The Legislature's decision to exempt nonresidential CIDs from Section 1368 appears to have been based on its perception that prospective buyers of interests

in nonresidential CIDs are sophisticated business owners, and therefore capable of doing their own due diligence before purchasing. The Legislature likely further determined that, to the extent the disclosures in Section 1368 might provide some benefit to prospective purchasers, that benefit would be outweighed by the burden the section would impose on existing owners.

The potential benefit that Section 1368 would offer prospective buyers of nonresidential interests is relatively clear. Most of the items required to be disclosed by the section seem reasonably designed to inform a prospective purchaser of important information about the CID. (One of the disclosures, mandated by Section 1368(a)(3), relates to financial documentation that is not required to be provided by a nonresidential CID. See Civ. Code §§ 1365, 1373(a)(4).)

The burden these disclosures would create for sellers is not quite as apparent. The disclosures do not seem unduly complex or costly to provide (they are required to be provided by often unsophisticated residential sellers). Moreover, most moderately sophisticated buyers probably already *ask* nonresidential sellers to provide many of the items listed in Section 1368, as a matter of routine.

Nevertheless, there are also likely many cases in which prospective buyers do not want or care about some of the disclosures required by Section 1368. This is an important consideration as well, as each such case represents unnecessary expense to the seller, as well as to a lesser extent to the CID association that has to provide copies to the seller.

Recommendation

After balancing the relevant policy considerations, the Legislature has determined that Section 1368 should be included in the list of nonresidential CID exemptions in Section 1373. In the absence of strong reason to decide otherwise, that determination is entitled to appropriate deference.

The staff solicits input from interested persons on this issue. However, unless the Commission receives comment indicating that the prior legislative decision on this exemption has been causing a problem**, the staff recommends that Section 1368 continue to be inapplicable to a nonresidential CID.**

Civ. Code § 1363(b). Compliance with Sections 1365 and 1368

Another provision originally listed in Section 1373 is Civil Code Section 1363(b), which relates to the two provisions just discussed. Civil Code Section 1373(a)(3) makes Civil Code Section 1363(b) inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1363(b) simply requires a CID to comply with Sections 1365 and 1368. As discussed above, those two sections are also made inapplicable to a nonresidential CID by Section 1373.

Whether Section 1363(b) should be applicable to a nonresidential CID (in whole or in part) depends on the Commission's decisions about Sections 1365 and 1368. Because the staff has tentatively recommended that Sections 1365 and 1368 continue to be inapplicable to a nonresidential CID, **we also recommend that Section 1363(b) continue to be inapplicable to a nonresidential CID**.

Civ. Code § 1365.5. Reserve Study and Limitations

Another provision originally listed in Civil Code Section 1373 is Civil Code Section 1365.5. Civil Code Section 1373(a)(5) makes Civil Code Section 1365.5 inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1365.5 requires the board of directors of a CID association to conduct a periodic review of the association's financial documents and information, and to conduct a periodic study to assess the adequacy of the association's reserve accounts. The section then limits how these reserve funds may be spent, and regulates the levying of special assessments to fund the reserve accounts.

Substantially Overlapping Provision of Commercial Law

The staff is unaware of any provision of commercial law that substantially duplicates Section 1365.5.

However, the staff has been informally advised that some accounting standards may exist that — if followed by a governing board — serve a function similar to Section 1365.5. These standards require identification of reasonably expected future expenditures, and disclosure of whether or how the association plans to address those expenditures.

Considerations Specific to a Nonresidential CID

Similar to Section 1365, the Legislature's exemption of nonresidential CIDs from application of these provisions appears substantially based on a perception that business owners are sophisticated enough to make necessary decisions regarding the financial management of the CIDs in which they own an interest.

However, while Section 1365 concerns only the maintenance and disclosure of financial information, Section 1365.5 is also intended to protect the financial stability of the community. At least in residential CIDs, reserve accounts are often underfunded, and major repairs that are not properly planned for can cause significant problems. The staff does not know whether these problems are more common in residential CIDs than in nonresidential CIDs.

The need of nonresidential owners for reserve studies may be sufficiently addressed either by their own due diligence, or by their board's adherence to relevant accounting standards. Whether this is true would appear to turn largely on the sophisticated business owner rationale discussed previously. If it is not true, an uninformed owner in a nonresidential CID could experience problems similar to those of a residential owner, if an unexpected major repair to the CID was suddenly needed.

However, the staff has heard nothing indicating that the Legislature's exemption of nonresidential CIDs from Section 1365.5 has been causing any such problem. **The staff solicits comment on this issue from interested persons.** But at this time, there appears to be nothing other than a theoretical basis for disturbing the Legislature's determination on this issue.

Recommendation

Unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that Section 1365.5 continue to be inapplicable to a nonresidential CID.**

Civ. Code § 1366(b). Assessment Increases

Another provision originally listed in Civil Code Section 1373 is Civil Code Section 1366(b). Civil Code Section 1373(a)(6) makes Civil Code Section 1366(b) inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1366(b) allows a CID board, notwithstanding more restrictive provisions in the CID declaration, to impose regular and special assessments up to certain percentages specified in the section, without owner consent. Regular assessments may be increased to up to 120% of the regular assessments for the previous fiscal year, and special assessments may total up to 5% of budgeted gross expenses of the association for the previous fiscal year.

The section also permits assessments to exceed those percentages, again notwithstanding more restrictive provisions in the CID declaration, if a majority of the voting power of the association approves.

Substantially Overlapping Provision of Commercial Law

The staff is unaware of any provision of commercial law that substantially duplicates Section 1366(b).

Considerations Specific to a Nonresidential CID

Section 1366(b) serves two purposes. It allows a CID board to deviate from an assessment provision in the CID's declaration when necessary, and it also prevents the board from increasing assessments beyond specified percentages without member consent.

With regard to allowing deviation from an assessment provision in the declaration, considerations relating to this exemption are similar to the considerations underlying the exemption of a nonresidential CID from Section 1356 (relating to a restrictive supermajority voting requirement in a CID declaration). See the above discussion of Section 1356.

The deviation permitted by Section 1366(b), if available to a nonresidential CID, would provide the CID greater flexibility in imposing assessments in the event of unanticipated need. However, allowing the deviation could frustrate the expectations of owners who *relied* on that restrictive declaration provision, when purchasing an interest in the development. Moreover, unlike Section 1356, Section 1366(b) allows a board to circumvent an assessment provision in a declaration without any judicial stamp of approval, making the "benefit of the bargain" rationale discussed previously even more compelling.

Section 1366(b) also prevents a board from increasing assessments beyond the percentages specified in the section, without owner consent. Here the rationale

articulated in the Senate Rules Committee analysis relating to the different operational needs of a nonresidential CID is pertinent:

> The operational needs of commercial and industrial common interest developments are different than those of a residential association, e.g., "An individual business owner's assessment may increase disproportionately, but fairly, in a given assessment period based on business expansion, change of use, or other negotiated factors, such as an extrahazardous use which raises insurance premiums."
>
> Business parks often add amenities and new facilities as the park is developed. Increased assessments are needed in a timely manner to pay for improvements. Unlike residential owners, business owners pass these increased costs on to their customers.

Exhibit pp. 2-3.

As indicated in that analysis, preventing a nonresidential board from increasing an assessment beyond the specified percentage may be problematic for a nonresidential CID. A nonresidential CID needs maximum flexibility with regard to imposing assessments, both because of the diverse uses of its owner businesses, as well the need to frequently add amenities to the development. In addition, a substantial assessment increase can perhaps be borne more easily by nonresidential owners, who may be able to pass at least some of the increase on to their customers.

Recommendation

Again, the staff has received no word indicating that the exemption of nonresidential CIDs from Section 1366(b) has been causing any problem. Unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that Section 1366(b) continue to be inapplicable to a nonresidential CID.**

Civ. Code § 1366.1. Limit on Assessment to Actual Cost

Another provision originally listed in Section 1373 is Civil Code Section 1366.1. Civil Code Section 1373(a)(7) makes Civil Code Section 1366.1 inapplicable to a nonresidential CID.

Description of Exempted Provision

Section 1366.1 provides that a CID association may not impose or collect an assessment that exceeds the cost for which it is levied.

Substantially Overlapping Provision of Commercial Law

The staff is unaware of any provision of commercial law that substantially duplicates Section 1366.1.

Considerations Specific to a Nonresidential CID

Section 1366.1 restricts an association from collecting assessments from its owners for anything other than actual cost of needed expenditures. Although there is sparse appellate authority construing the section, the section would appear to bar certain types of more sophisticated financial planning that a CID might find useful. For example, an association might deem it appropriate to increase assessments in a particular year beyond expected expenditures, in order to offset the impact of an impending change in the law, or the composition of the CID itself.

This degree of financial regulation may be needed in residential CIDs, where neither residents nor directors in a particular CID may have any formal financial training. However, the Legislature has apparently decided that a group of business owners do not need this same protection, at least at the cost of potentially advantageous financial planning.

The staff sees no compelling reason to overturn that determination.

Recommendation

Unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that Section 1366.1 continue to be inapplicable to a nonresidential CID.**

RECENT ADDITIONS TO SECTION 1373

Since 1988, two additions have been made to the list of exemptions in Section 1373. See 2003 Cal. Stat. ch. 57, Civ. Code § 1357.100 et seq.; 2004 Cal. Stat. ch. 346, Civ. Code § 1378. Both additions occurred in connection with legislation recommended by the Commission.

Civ. Code § 1357.100 et seq. Rulemaking Procedures

Civil Code Section 1373(a)(2) makes Article 4 (commencing with Section 1357.100) of the Davis-Stirling Act inapplicable to a nonresidential CID.

Description of Exempted Provisions

In 2003, as part of its ongoing study of CIDs, the Commission recommended revisions relating to the development of operating rules in a CID. See *Common Interest Development Law: Association Rulemaking and Decisionmaking*, 33 Cal. L. Revision Comm'n Reports 81 (2003) (hereafter, "*CID Rulemaking*"). Operating rules constitute a "governing document" in many CIDs, regulating various aspects of the development. See Civ. Code § 1351(j).

Prior to the implementation of the Commission's recommendation on this subject, the Davis-Stirling Act contained no provisions addressing either the adoption or enforcement of these rules. The Commission recognized this as a problem, because operating rules can have a significant effect on the interests of the owners in the CID. *CID Rulemaking*, *supra*, at 88. The Commission therefore recommended the enactment of provisions that would provide notice to owners and an opportunity to comment before an operating rule was adopted or changed, would provide owners with a procedure to reverse a problematic operating rule, and would clarify that an operating rule was invalid if it contradicted or was not authorized by law or any of the other governing documents of the CID. *Id.*

While a bill that would implement the Commission's recommendation was pending, the Community Associations Institute ("CAI") recommended that the bill be amended to exempt nonresidential CIDs from the new rulemaking procedures.

The bill's author and the Commission accepted that amendment. The Commission agreed that the new provisions had not been developed with nonresidential CIDs in mind, and the consequences if applied to nonresidential CIDs were unknown. See CLRC Memorandum 2003-23, pp. 4-6. The bill was amended to include the new rulemaking provisions within the list of exemptions in Section 1373, and enacted in that form. See 2003 Cal. Stat. ch. 557, Civ. Code § 1357.100 et seq.

Overlapping Provision of Commercial Law

The staff is unaware of any provision of commercial law that addresses the material governed by the provisions of Article 4 (commencing with Section 1357.100) of the Davis-Stirling Act.

Differing Needs of a Nonresidential CID

In the Commission's study of the rulemaking provisions prior to its final recommendation, the Commission did not analyze the applicability of the rules to nonresidential CIDs. However, as the focus of the study had been exclusively on whether the provisions were appropriate for residential CIDs, the Commission agreed it would be prudent for the implementing legislation to make the new provisions applicable only to residential CIDs.

It appears that the Legislature was guided by similar considerations. A review of the committee analyses of the bill implementing the Commission's recommendation (AB 512 (Bates), 2003 Cal. Stat. ch. 557) does not reveal any extended discussion relating to whether the rulemaking provisions should be applicable or inapplicable to nonresidential CIDs.

All CIDs, including nonresidential CIDs, are implicitly authorized to create and implement operating rules by Civil Code Section 1351(j). But the Davis-Stirling Act presently contains no provisions regulating the implementation of those rules in nonresidential CIDs. In theory, it would seem the objective of the Commission in formulating its prior recommendation — providing procedural fairness in association rulemaking and decisionmaking — would provide an equal benefit in nonresidential CIDs.

But theory aside, is the absence of rulemaking provisions applicable to nonresidential CIDs causing any real-world problem? If not, there would not appear to be any reason to overturn the Legislature's recent determination on this issue, and impose unneeded (and likely unwanted) additional regulation on nonresidential CIDs. In its prior study, the Commission had received word of problems in residential CIDs attributable to the absence of operating rules. So far, the Commission has received no such word from any owners in nonresidential CIDs.

Recommendation

The staff solicits further comment from interested persons on this issue. However, unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that the provisions contained in Article 4 (commencing with Section 1357.100) of the Davis-Stirling Act continue to be inapplicable to a nonresidential CID.**

Civ. Code § 1378. Architectural Review Procedures

Civil Code Section 1373(a)(9) makes Civil Code Section 1378 inapplicable to a nonresidential CID.

Description of Exempted Provision

In 2004, the Commission recommended improvements to the law governing association review of an owner's proposed architectural changes to a separate interest. See *Common Interest Development Law: Architectural Review and Decisionmaking*, 34 Cal. L. Revision Comm'n Reports 107 (2004). Many CIDs require association review and approval of changes, to ensure that they meet architectural or aesthetic standards.

These recommended improvements were originally a part of the Commission's recommendation on CID rulemaking procedures discussed previously, but for legislative reasons were submitted as a separate recommendation. See *CID Rulemaking, supra*; CLRC Memorandum 2003-36. The provisions generally apply some of the Commission's previously recommended rulemaking procedures to architectural review by an association.

Overlapping Provision of Commercial Law

The staff is unaware of any provision of commercial law that substantially duplicates the provisions of Section 1378.

Differing Needs of a Nonresidential CID

As with the Commission's recommended rulemaking provisions, it does not appear that the applicability of these provisions to nonresidential CIDs was previously discussed or analyzed. However, as the focus of the Commission study had been solely on whether the provisions were appropriate for residential CIDs, the Commission recommended that the provisions be added to the list of exemptions in Section 1373. As with the rulemaking provisions, the Legislature agreed. Once again, a review of the analyses of the bill implementing the recommendation (AB 2376 (Bates), 2004 Cal. Stat. ch. 346) does not reveal any extended discussion of that issue.

Recommendation

To the extent that the absence of rulemaking procedures in a nonresidential CID represents a real-world problem, that problem could extend to the area of

architectural review (although this does seem to be an area of lesser importance in a nonresidential CID). However, again, the staff so far has received no complaints about this issue, or any other information that would serve as a basis for overturning the Legislature's decision on the issue.

The staff solicits comment from interested persons on this issue. However, unless the Commission receives comment raising a compelling argument to the contrary, **the staff recommends that Section 1378 continue to be inapplicable to a nonresidential CID.**

NEXT STEP

This memorandum has presented an analysis of the policy considerations underlying the existing exemptions from the Davis-Stirling Act for a nonresidential CID. The staff's tentative conclusion regarding each of those exemptions is to respect the Legislature's policy determination and leave the exemption in place. **We encourage comment on these tentative conclusions.**

If the Commission agrees with the staff's recommendations, the next step will be to determine whether any other provisions in the Davis-Stirling Act are substantially similar to the existing exemptions listed in Section 1373. If so, it may be appropriate to create additional exemptions for a nonresidential CID, to be listed in Section 1373 along with the existing exemptions. Unless the Commission makes decisions that warrant a different approach, we plan to undertake such an analysis in our next memorandum on this topic.

Respectfully submitted,

Steve Cohen
Staff Counsel

CONSENT

SENATE RULES COMMITTEE

Office of
Senate Floor Analyses
1100 J Street, Suite 120
445-6614

Bill No.	AB 2484
Author:	Hauser (D)
Amended:	1/7/88 in Assembly
Vote Required:	Majority

Committee Votes:

COMMITTEE: HOUSING & U.A.
BILL NO.: AB 2484
DATE OF HEARING: 3-17-88

SENATORS:	AYE	NO
Kopp	✓	
Lockyer		
Petris		
Royce	✓	
Torres		
Rogers (VC)	✓	
L. Greene (Ch)	✓	
TOTAL:	4	0

Senate Floor Vote:

Assembly Floor Vote: 71-0, p. 5566, 1/21/88

SUBJECT: Common interest developments: exclusion of developments zoned industrial or commercial

SOURCE: Author

DIGEST: This bill exempts specified commercial and industrial common interest developments from certain sections of the Davis-Stirling Common Interest Development Act.

ANALYSIS: Existing law sets out requirements and procedures for forming and operating common interest developments which may include community apartment projects, condominium projects, planned developments, and stock cooperatives. The rights, obligations, and relationships of homeowners, homeowner associations, tenants, purchasers and developers are described in the act.

This bill exempts common interest developments that are expressly zoned as industrial or commercial developments and limited in use to industrial or commercial purposes from the following sections of the Davis-Stirling Common Interest Development Act:

1. Section 1356, allows an association to petition a ccurt for permission to amend a declaration under limited conditions.

2. Sections 1365 and 1365.5, require financial statements to be prepared and distributed at certain times and require the board of directors of an association to perform certain fiscal duties and require joint signatures for use of moneys.

CONTINUED

3. Section 1366.1, provides that no assessment or fee can exceed the purpose for which it is levied.

4. Section 1368, requires certain documents be provided to a prospective purchaser before the sale or transfer of title including any age restrictions on residency or occupancy limits.

5. Section 1363(b), requires the board to prepare budget pursuant to Section 1365, above.

6. Section 1366(b), provides a limit of 20 percent on regular assessment increases.

According to the author's office, the above provisions were enacted to benefit residential common interest developments by:

A. Providing a method to amend governing documents when an association has obtained more than 50 percent of the votes of the members, but the governing documents require a higher percentage, in some cases 75 percent and higher.

B. Requiring residential associations to prepare accurate budgets, maintain reserve accounts, and improve fiscal responsibility and accountability.

C. Protecting residential owners from the use of fees to raise money beyond the actual need of the development.

D. Providing prospective purchasers with governing documents, financial information, and specific restrictions of the common interest development.

FISCAL EFFECT: Appropriation: No Fiscal Committee: No Local: No

SUPPORT: (Verified 5/17/88)

California Building Industry Association
Community Associations Institute
AVDCO Group (developer)
Browning Wholey and McLoughlin (law firm)
San Francisco Development Company

ARGUMENTS IN SUPPORT: According to the author's office:

1. Commercial and industrial common interest developments are business endeavors in which the parties engage the professional services of attorneys, accountants, management companies, and developers. Unlike groups of neighbors providing for the governance of their living conditions, these business people are well informed and governed by other provisions of commercial law.

2. The operational needs of commercial and industrial common interest developments are different than those of a residential association, e.g., "An individual business owner's assessment may increase disproportionately, but fairly, in a given assessment period based on business expansion, change

CONTINUED

of use, or other negotiated factors, such as an extrahazardous use which raises insurance premiums."

3. Business parks often add amenities and new facilities as the park is developed. Increased assessments are needed in a timely manner to pay for improvements. Unlike residential owners, business owners pass these increased costs on to their customers.

4. Regulatory requirements designed to protect individuals in residential developments are inappropriate in business developments, interfere with commerce, and increase the costs of doing business.

NM:ctl 5/18/88 Senate Flood Analyses

SELECTED PROVISIONS OF THE DAVIS-STIRLING ACT
(CIV. CODE §§ 1350-1378)

1356. (a) If in order to amend a declaration, the declaration requires owners having more than 50 percent of the votes in the association, in a single class voting structure, or owners having more than 50 percent of the votes in more than one class in a voting structure with more than one class, to vote in favor of the amendment, the association, or any owner of a separate interest, may petition the superior court of the county in which the common interest development is located for an order reducing the percentage of the affirmative votes necessary for such an amendment. The petition shall describe the effort that has been made to solicit approval of the association members in the manner provided in the declaration, the number of affirmative and negative votes actually received, the number or percentage of affirmative votes required to effect the amendment in accordance with the existing declaration, and other matters the petitioner considers relevant to the court's determination. The petition shall also contain, as exhibits thereto, copies of all of the following:

(1) The governing documents.

(2) A complete text of the amendment.

(3) Copies of any notice and solicitation materials utilized in the solicitation of owner approvals.

(4) A short explanation of the reason for the amendment.

(5) Any other documentation relevant to the court's determination.

(b) Upon filing the petition, the court shall set the matter for hearing and issue an ex parte order setting forth the manner in which notice shall be given.

(c) The court may, but shall not be required to, grant the petition if it finds all of the following:

(1) The petitioner has given not less than 15 days written notice of the court hearing to all members of the association, to any mortgagee of a mortgage or beneficiary of a deed of trust who is entitled to notice under the terms of the declaration, and to the city, county, or city and county in which the common interest development is located that is entitled to notice under the terms of the declaration.

(2) Balloting on the proposed amendment was conducted in accordance with all applicable provisions of the governing documents.

(3) A reasonably diligent effort was made to permit all eligible members to vote on the proposed amendment.

(4) Owners having more than 50 percent of the votes, in a single class voting structure, voted in favor of the amendment. In a voting

structure with more than one class, where the declaration requires a majority of more than one class to vote in favor of the amendment, owners having more than 50 percent of the votes of each class required by the declaration to vote in favor of the amendment voted in favor of the amendment.

(5) The amendment is reasonable.

(6) Granting the petition is not improper for any reason stated in subdivision (e).

(d) If the court makes the findings required by subdivision (c), any order issued pursuant to this section may confirm the amendment as being validly approved on the basis of the affirmative votes actually received during the balloting period or the order may dispense with any requirement relating to quorums or to the number or percentage of votes needed for approval of the amendment that would otherwise exist under the governing documents.

(e) Subdivisions (a) to (d), inclusive, notwithstanding, the court shall not be empowered by this section to approve any amendment to the declaration that:

(1) Would change provisions in the declaration requiring the approval of owners having more than 50 percent of the votes in more than one class to vote in favor of an amendment, unless owners having more than 50 percent of the votes in each affected class approved the amendment.

(2) Would eliminate any special rights, preferences, or privileges designated in the declaration as belonging to the declarant, without the consent of the declarant.

(3) Would impair the security interest of a mortgagee of a mortgage or the beneficiary of a deed of trust without the approval of the percentage of the mortgagees and beneficiaries specified in the declaration, if the declaration requires the approval of a specified percentage of the mortgagees and beneficiaries.

(f) An amendment is not effective pursuant to this section until the court order and amendment have been recorded in every county in which a portion of the common interest development is located. The amendment may be acknowledged by, and the court order and amendment may be recorded by, any person designated in the declaration or by the association for that purpose, or if no one is designated for that purpose, by the president of the association. Upon recordation of the amendment and court order, the declaration, as amended in accordance with this section, shall have the same force and effect as if the amendment were adopted in compliance with every requirement imposed by the governing documents.

(g) Within a reasonable time after the amendment is recorded the association shall mail a copy of the amendment to each member of the association, together with a statement that the amendment has been recorded.

ARTICLE 4.

1357.100. As used in this article:

(a) "Operating rule" means a regulation adopted by the board of directors of the association that applies generally to the management and operation of the common interest development or the conduct of the business and affairs of the association.

(b) "Rule change" means the adoption, amendment, or repeal of an operating rule by the board of directors of the association.

1357.110. An operating rule is valid and enforceable only if all of the following requirements are satisfied:

(a) The rule is in writing.

(b) The rule is within the authority of the board of directors of the association conferred by law or by the declaration, articles of incorporation or association, or bylaws of the association.

(c) The rule is not inconsistent with governing law and the declaration, articles of incorporation or association, and bylaws of the association.

(d) The rule is adopted, amended, or repealed in good faith and in substantial compliance with the requirements of this article.

(e) The rule is reasonable.

1357.120. (a) Sections 1357.130 and 1357.140 only apply to an operating rule that relates to one or more of the following subjects:

(1) Use of the common area or of an exclusive use common area.

(2) Use of a separate interest, including any aesthetic or architectural standards that govern alteration of a separate interest.

(3) Member discipline, including any schedule of monetary penalties for violation of the governing documents and any procedure for the imposition of penalties.

(4) Any standards for delinquent assessment payment plans.

(5) Any procedures adopted by the association for resolution of disputes.

(6) Any procedures for reviewing and approving or disapproving a proposed physical change to a member's separate interest or to the common area.

(7) Procedures for elections.

(b) Sections 1357.130 and 1357.140 do not apply to the following actions by the board of directors of an association:

(1) A decision regarding maintenance of the common area.

(2) A decision on a specific matter that is not intended to apply generally.

(3) A decision setting the amount of a regular or special assessment.

(4) A rule change that is required by law, if the board of directors has no discretion as to the substantive effect of the rule change.

(5) Issuance of a document that merely repeats existing law or the governing documents.

1357.130. (a) The board of directors shall provide written notice of a proposed rule change to the members at least 30 days before making the rule change. The notice shall include the text of the proposed rule change and a description of the purpose and effect of the proposed rule change. Notice is not required under this subdivision if the board of directors determines that an immediate rule change is necessary to address an imminent threat to public health or safety or imminent risk of substantial economic loss to the association.

(b) A decision on a proposed rule change shall be made at a meeting of the board of directors, after consideration of any comments made by association members.

(c) As soon as possible after making a rule change, but not more than 15 days after making the rule change, the board of directors shall deliver notice of the rule change to every association member. If the rule change was an emergency rule change made under subdivision (d), the notice shall include the text of the rule change, a description of the purpose and effect of the rule change, and the date that the rule change expires.

(d) If the board of directors determines that an immediate rule change is required to address an imminent threat to public health or safety, or an imminent risk of substantial economic loss to the association, it may make an emergency rule change; and no notice is required, as specified in subdivision (a). An emergency rule change is effective for 120 days, unless the rule change provides for a shorter effective period. A rule change made under this subdivision may not be readopted under this subdivision.

(e) A notice required by this section is subject to Section 1350.7.

1357.140. (a) Members of an association owning 5 percent or more of the separate interests may call a special meeting of the members to reverse a rule change.

(b) A special meeting of the members may be called by delivering a written request to the president or secretary of the board of directors, after which the board shall deliver notice of the meeting to the association's members and hold the meeting in conformity with Section 7511 of the Corporations Code. The written request may not be delivered more than 30 days after the members of the association are notified of the rule change. Members are deemed to have been notified of a rule change on delivery of notice of the rule change, or on enforcement of the

resulting rule, whichever is sooner. For the purposes of Section 8330 of the Corporations Code, collection of signatures to call a special meeting under this section is a purpose reasonably related to the interests of the members of the association. A member request to copy or inspect the membership list solely for that purpose may not be denied on the grounds that the purpose is not reasonably related to the member's interests as a member.

(c) The rule change may be reversed by the affirmative vote of a majority of the votes represented and voting at a duly held meeting at which a quorum is present (which affirmative votes also constitute a majority of the required quorum), or if the declaration or bylaws require a greater proportion, by the affirmative vote or written ballot of the proportion required. In lieu of calling the meeting described in this section, the board may distribute a written ballot to every member of the association in conformity with the requirements of Section 7513 of the Corporations Code.

(d) Unless otherwise provided in the declaration or bylaws, for the purposes of this section, a member may cast one vote per separate interest owned.

(e) A meeting called under this section is governed by Chapter 5 (commencing with Section 7510) of Part 3 of Division 2 of Title 1 of, and Sections 7612 and 7613 of, the Corporations Code.

(f) A rule change reversed under this section may not be readopted for one year after the date of the meeting reversing the rule change. Nothing in this section precludes the board of directors from adopting a different rule on the same subject as the rule change that has been reversed.

(g) As soon as possible after the close of voting, but not more than 15 days after the close of voting, the board of directors shall provide notice of the results of a member vote held pursuant to this section to every association member. Delivery of notice under this subdivision is subject to Section 1350.7.

(h) This section does not apply to an emergency rule change made under subdivision (d) of Section 1357.130.

1357.150. (a) This article applies to a rule change commenced on or after January 1, 2004.

(b) Nothing in this article affects the validity of a rule change commenced before January 1, 2004.

(c) For the purposes of this section, a rule change is commenced when the board of directors of the association takes its first official action leading to adoption of the rule change.

1363. (a) ….

(b) An association, whether incorporated or unincorporated, shall prepare a budget pursuant to Section 1365 and disclose information, if requested, in accordance with Section 1368.

1365. Unless the governing documents impose more stringent standards, the association shall prepare and distribute to all of its members the following documents:

(a) A pro forma operating budget, which shall include all of the following:

(1) The estimated revenue and expenses on an accrual basis.

(2) A summary of the association's reserves based upon the most recent review or study conducted pursuant to Section 1365.5, based only on assets held in cash or cash equivalents, which shall be printed in boldface type and include all of the following:

(A) The current estimated replacement cost, estimated remaining life, and estimated useful life of each major component.

(B) As of the end of the fiscal year for which the study is prepared:

(i) The current estimate of the amount of cash reserves necessary to repair, replace, restore, or maintain the major components.

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

(iii) If applicable, the amount of funds received from either a compensatory damage award or settlement to an association from any person or entity for injuries to property, real or personal, arising out of any construction or design defects, and the expenditure or disposition of funds, including the amounts expended for the direct and indirect costs of repair of construction or design defects. These amounts shall be reported at the end of the fiscal year for which the study is prepared as separate line items under cash reserves pursuant to clause (ii). Instead of complying with the requirements set forth in this clause, an association that is obligated to issue a review of their financial statement pursuant to subdivision (b) may include in the review a statement containing all of the information required by this clause.

(C) The percentage that the amount determined for purposes of clause (ii) of subparagraph (B) equals the amount determined for purposes of clause (i) of subparagraph (B).

(D) The current deficiency in reserve funding expressed on a per unit basis. The figure shall be calculated by subtracting the amount determined for purposes of clause (ii) of subparagraph (B) from the amount determined for purposes of clause (i) of subparagraph (B) and then dividing the result by the number of separate interests within the association, except that if assessments vary by the size or type of ownership interest, then the association

shall calculate the current deficiency in a manner that reflects the variation.

(3) A statement as to all of the following:

(A) Whether the board of directors of the association has determined to defer or not undertake repairs or replacement of any major component with a remaining life of 30 years or less, including a justification for the deferral or decision not to undertake the repairs or replacement.

(B) Whether the board of directors of the association, consistent with the reserve funding plan adopted pursuant to subdivision (e) of Section 1365.5, has determined or anticipates that the levy of one or more special assessments will be required to repair, replace, or restore any major component or to provide adequate reserves therefor. If so, the statement shall also set out the estimated amount, commencement date, and duration of the assessment.

(C) The mechanism or mechanisms by which the board of directors will fund reserves to repair or replace major components, including assessments, borrowing, use of other assets, deferral of selected replacements or repairs, or alternative mechanisms.

(D) Whether the association has any outstanding loans with an original term of more than one year, including the payee, interest rate, amount outstanding, annual payment, and when the loan is scheduled to be retired.

(4) A general statement addressing the procedures used for the calculation and establishment of those reserves to defray the future repair, replacement, or additions to those major components that the association is obligated to maintain. The report shall include, but need not be limited to, reserve calculations made using the formula described in paragraph (4) of subdivision (b) of Section 1365.2.5, and may not assume a rate of return on cash reserves in excess of 2 percent above the discount rate published by the Federal Reserve Bank of San Francisco at the time the calculation was made.

The summary of the association's reserves disclosed pursuant to paragraph (2) shall not be admissible in evidence to show improper financial management of an association, provided that other relevant and competent evidence of the financial condition of the association is not made inadmissible by this provision.

Notwithstanding a contrary provision in the governing documents, a copy of the operating budget shall be annually distributed not less than 30 days nor more than 90 days prior to the beginning of the association's fiscal year.

(b) Commencing January 1, 2009, a summary of the reserve funding plan adopted by the board of directors of the association, as specified in paragraph (4) of subdivision (e) of Section 1365.5. The summary shall include notice to members that the full reserve study plan is available upon request, and the association shall provide the full reserve plan to any member upon request.

(c) A review of the financial statement of the association shall be prepared in accordance with generally accepted accounting principles by a licensee of the California Board of Accountancy for any fiscal year in which the gross income to the association exceeds seventy-five thousand dollars ($75,000). A copy of the review of the financial statement shall be distributed within 120 days after the close of each fiscal year.

(d) Instead of the distribution of the pro forma operating budget required by subdivision (a), the board of directors may elect to distribute a summary of the pro forma operating budget to all of its members with a written notice that the pro forma operating budget is available at the business office of the association or at another suitable location within the boundaries of the development, and that copies will be provided upon request and at the expense of the association. If any member requests that a copy of the pro forma operating budget required by subdivision (a) be mailed to the member, the association shall provide the copy to the member by first-class United States mail at the expense of the association and delivered within five days. The written notice that is distributed to each of the association members shall be in at least 10-point boldface type on the front page of the summary of the budget.

(e) A statement describing the association's policies and practices in enforcing lien rights or other legal remedies for default in payment of its assessments against its members shall be annually delivered to the members not less than 30 days nor more than 90 days immediately preceding the beginning of the association's fiscal year.

(f)(1) A summary of the association's property, general liability, earthquake, flood, and fidelity insurance policies, which shall be distributed not less than 30 days nor more than 90 days preceding the beginning of the association's fiscal year, that includes all of the following information about each policy:

(A) The name of the insurer.

(B) The type of insurance.

(C) The policy limits of the insurance.

(D) The amount of deductibles, if any.

(2) The association shall, as soon as reasonably practicable, notify its members by first-class mail if any of the policies described in paragraph (1) have lapsed, been canceled, and are not immediately renewed, restored, or replaced, or if there is a significant change, such as a reduction in coverage or limits or an increase in the deductible, as to any of those policies. If the association receives any notice of nonrenewal of a policy described in paragraph (1), the association shall immediately notify its members if replacement coverage will not be in effect by the date the existing coverage will lapse.

(3) To the extent that any of the information required to be disclosed pursuant to paragraph (1) 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 to all of its members.

(4) The summary distributed pursuant to paragraph (1) shall contain, in at least 10-point boldface type, the following statement: "This summary of the association's policies of insurance provides only certain information, as required by subdivision (f) of Section 1365 of the Civil Code, and should not be considered a substitute for the complete policy terms and conditions contained in the actual policies of insurance. Any association member may, upon request and provision of reasonable notice, review the association's insurance policies and, upon request and payment of reasonable duplication charges, obtain copies of those policies. Although the association maintains the policies of insurance specified in this summary, the association's policies of insurance may not cover your property, including personal property or, real property improvements to or around your dwelling, or personal injuries or other losses that occur within or around your dwelling. Even if a loss is covered, you may nevertheless be responsible for paying all or a portion of any deductible that applies. Association members should consult with their individual insurance broker or agent for appropriate additional coverage."

1365.5. (a) Unless the governing documents impose more stringent standards, the board of directors of the association shall do all of the following:

(1) Review a current reconciliation of the association's operating accounts on at least a quarterly basis.

(2) Review a current reconciliation of the association's reserve accounts on at least a quarterly basis.

(3) Review, on at least a quarterly basis, the current year's actual reserve revenues and expenses compared to the current year's budget.

(4) Review the latest account statements prepared by the financial institutions where the association has its operating and reserve accounts.

(5) Review an income and expense statement for the association's operating and reserve accounts on at least a quarterly basis.

(b) The signatures of at least two persons, who shall be members of the association's board of directors, or one officer who is not a member of the board of directors and a member of the board of directors, shall be required for the withdrawal of moneys from the association's reserve accounts.

(c)(1) The board of directors shall not expend funds designated as reserve funds for any purpose other than the repair, restoration, replacement, or maintenance of, or litigation involving the repair, restoration, replacement, or maintenance of, major components that

the association is obligated to repair, restore, replace, or maintain and for which the reserve fund was established.

(2) However, the board may authorize the temporary transfer of moneys from a reserve fund to the association's general operating fund to meet short-term cashflow requirements or other expenses, if the board has provided notice of the intent to consider the transfer in a notice of meeting, which shall be provided as specified in Section 1363.05. The notice shall include the reasons the transfer is needed, some of the options for repayment, and whether a special assessment may be considered. If the board authorizes the transfer, the board shall issue a written finding, recorded in the board's minutes, explaining the reasons that the transfer is needed, and describing when and how the moneys will be repaid to the reserve fund. The transferred funds shall be restored to the reserve fund within one year of the date of the initial transfer, except that the board may, after giving the same notice required for considering a transfer, and, upon making a finding supported by documentation that a temporary delay would be in the best interests of the common interest development, temporarily delay the restoration. The board shall exercise prudent fiscal management in maintaining the integrity of the reserve account, and shall, if necessary, levy a special assessment to recover the full amount of the expended funds within the time limits required by this section. This special assessment is subject to the limitation imposed by Section 1366. The board may, at its discretion, extend the date the payment on the special assessment is due. Any extension shall not prevent the board from pursuing any legal remedy to enforce the collection of an unpaid special assessment.

(d) When the decision is made to use reserve funds or to temporarily transfer moneys from the reserve fund to pay for litigation, the association shall notify the members of the association of that decision in the next available mailing to all members pursuant to Section 5016 of the Corporations Code, and of the availability of an accounting of those expenses. Unless the governing documents impose more stringent standards, the association shall make an accounting of expenses related to the litigation on at least a quarterly basis. The accounting shall be made available for inspection by members of the association at the association's office.

(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. The board shall review this study, or cause it to be reviewed, annually and shall consider and implement necessary

adjustments to the board's analysis of the reserve account requirements as a result of that review.

The study required by this subdivision shall at a minimum include:

(1) Identification of the major components that the association is obligated to repair, replace, restore, or maintain that, as of the date of the study, have a remaining useful life of less than 30 years.

(2) Identification of the probable remaining useful life of the components identified in paragraph (1) as of the date of the study.

(3) An estimate of the cost of repair, replacement, restoration, or maintenance of the components identified in paragraph (1).

(4) An estimate of the total annual contribution necessary to defray the cost to repair, replace, restore, or maintain the components identified in paragraph (1) during and at the end of their useful life, after subtracting total reserve funds as of the date of the study.

(5) A reserve funding plan that indicates how the association plans to fund the contribution identified in paragraph (4) to meet the association's obligation for the repair and replacement of all major components with an expected remaining life of 30 years or less, not including those components that the board has determined will not be replaced or repaired. The plan shall include a schedule of the date and amount of any change in regular or special assessments that would be needed to sufficiently fund the reserve funding plan. The plan shall be adopted by the board of directors at an open meeting before the membership of the association as described in Section 1363.05. If the board of directors determines that an assessment increase is necessary to fund the reserve funding plan, any increase shall be approved in a separate action of the board that is consistent with the procedure described in Section 1366.

(f) As used in this section, "reserve accounts" means both of the following:

(1) Moneys that the association's board of directors has identified for use to defray the future repair or replacement of, or additions to, those major components that the association is obligated to maintain.

(2) The funds received, and not yet expended or disposed of, from either a compensatory damage award or settlement to an association from any person or entity for injuries to property, real or personal, arising from any construction or design defects. These funds shall be separately itemized from funds described in paragraph (1).

(g) As used in this section, "reserve account requirements" means the estimated funds that the association's board of directors has determined are required to be available at a specified point in time to repair, replace, or restore those major components that the association is obligated to maintain.

(h) This section does not apply to an association that does not have a "common area" as defined in Section 1351.

1366. (a) ….

(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.

1366.1. An association shall not impose or collect an assessment or fee that exceeds the amount necessary to defray the costs for which it is levied.

1368. (a) The owner of a separate interest, other than an owner subject to the requirements of Section 11018.6 of the Business and Professions Code, shall, as soon as practicable before transfer of title to the separate interest or execution of a real property sales contract therefor, as defined in Section 2985, provide the following to the prospective purchaser:

(1) A copy of the governing documents of the common interest development, including any operating rules, and including a copy of the association's articles of incorporation, or, if not incorporated, a statement in writing from an authorized representative of the association that the association is not incorporated.

(2) If there is a restriction in the governing documents limiting the occupancy, residency, or use of a separate interest on the basis of age in a manner different from that provided in Section 51.3, a statement that the restriction is only enforceable to the extent permitted by Section 51.3 and a statement specifying the applicable provisions of Section 51.3.

(3) A copy of the most recent documents distributed pursuant to Section 1365.

(4) A true statement in writing obtained from an authorized representative of the association as to the amount of the association' s current regular and special assessments and fees, any assessments levied upon the owner's interest in the common interest development that are unpaid on the date of the statement, and any monetary fines or penalties levied upon the owner's interest and unpaid on the date of the statement. The statement obtained from an authorized representative shall also include true information on late charges, interest, and costs of collection which, as of the date of the statement, are or may be made a lien upon the owner's interest in a common interest development pursuant to Section 1367 or 1367.1.

(5) A copy or a summary of any notice previously sent to the owner pursuant to subdivision (h) of Section 1363 that sets forth any alleged violation of the governing documents that remains unresolved at the time of the request. The notice shall not be deemed a waiver of the association's right to enforce the governing documents against the owner or the prospective purchaser of the separate interest with respect to any violation. This paragraph shall not be construed to require an association to inspect an owner's separate interest.

(6) A copy of the preliminary list of defects provided to each member of the association pursuant to Section 1375, unless the association and the builder subsequently enter into a settlement agreement or otherwise resolve the matter and the association complies with Section 1375.1. Disclosure of the preliminary list of defects pursuant to this paragraph does not waive any privilege attached to the document. The preliminary list of defects shall also include a statement that a final determination as to whether the list of defects is accurate and complete has not been made.

(7) A copy of the latest information provided for in Section 1375.1.

(8) Any change in the association's current regular and special assessments and fees which have been approved by the association's board of directors, but have not become due and

payable as of the date disclosure is provided pursuant to this subdivision.

(b) Upon written request, an association shall, within 10 days of the mailing or delivery of the request, provide the owner of a separate interest with a copy of the requested items specified in paragraphs (1) to (8), inclusive, of subdivision (a). The items required to be made available pursuant to this section may be maintained in electronic form and requesting parties shall have the option of receiving them by electronic transmission or machine readable storage media if the association maintains these items in electronic form. The association may charge a reasonable fee for this service based upon the association's actual cost to procure, prepare, and reproduce the requested items.

(c)(1) Subject to the provisions of paragraph (2), neither an association nor a community service organization or similar entity may impose or collect any assessment, penalty, or fee in connection with a transfer of title or any other interest except for the following:

(A) An amount not to exceed the association's actual costs to change its records.

(B) An amount authorized by subdivision (b).

(2) The amendments made to this subdivision by the act adding this paragraph do not apply to a community service organization or similar entity that is described in subparagraph (A) or (B):

(A) The community service organization or similar entity satisfies both of the following requirements:

(i) The community service organization or similar entity was established prior to February 20, 2003.

(ii) The community service organization or similar entity exists and operates, in whole or in part, to fund or perform environmental mitigation or to restore or maintain wetlands or native habitat, as required by the state or local government as an express written condition of development.

(B) The community service organization or similar entity satisfies all of the following requirements:

(i) The community service organization or similar entity is not an organization or entity described in subparagraph (A).

(ii) The community service organization or similar entity was established and received a transfer fee prior to January 1, 2004.

(iii) On and after January 1, 2006, the community service organization or similar entity offers a purchaser the following payment options for the fee or charge it collects at time of transfer:

(I) Paying the fee or charge at the time of transfer.

(II) Paying the fee or charge pursuant to an installment payment plan for a period of not less than seven years. If the purchaser elects to pay the fee or charge in installment payments, the community service organization or similar entity may also collect additional amounts that do not exceed the actual costs for billing and financing on the amount owed. If the purchaser sells the separate

interest before the end of the installment payment plan period, he or she shall pay the remaining balance prior to transfer.

(3) For the purposes of this subdivision, a "community service organization or similar entity" means a nonprofit entity, other than an association, that is organized to provide services to residents of the common interest development or to the public in addition to the residents, to the extent community common areas or facilities are available to the public. A "community service organization or similar entity" does not include an entity that has been organized solely to raise moneys and contribute to other nonprofit organizations that are qualified as tax exempt under Section 501(c)(3) of the Internal Revenue Code and that provide housing or housing assistance.

(d) Any person or entity who willfully violates this section is liable to the purchaser of a separate interest that is subject to this section for actual damages occasioned thereby and, in addition, shall pay a civil penalty in an amount not to exceed five hundred dollars ($500). In an action to enforce this liability, the prevailing party shall be awarded reasonable attorneys' fees.

(e) Nothing in this section affects the validity of title to real property transferred in violation of this section.

(f) In addition to the requirements of this section, an owner transferring title to a separate interest shall comply with applicable requirements of Sections 1133 and 1134.

(g) For the purposes of this section, a person who acts as a community association manager is an agent, as defined in Section 2297, of the association.

1373. (a) The following provisions do not apply to a common interest development that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located:

(1) Section 1356.

(2) Article 4 (commencing with Section 1357.100) of Chapter 2 of Title 6 of Part 4 of Division 2.

(3) Subdivision (b) of Section 1363.

(4) Section 1365.

(5) Section 1365.5.

(6) Subdivision (b) of Section 1366.

(7) Section 1366.1.

(8) Section 1368.

(9) Section 1378.

(b) The Legislature finds that the provisions listed in subdivision (a) are appropriate to protect purchasers in residential common interest developments, however, the provisions may not be necessary to protect purchasers in commercial or industrial

developments since the application of those provisions could result in unnecessary burdens and costs for these types of developments.

1375. (a) Before an association files a complaint for damages against a builder, developer, or general contractor ("respondent") of a common interest development based upon a claim for defects in the design or construction of the common interest development, all of the requirements of this section shall be satisfied with respect to the builder, developer, or general contractor.

(b) The association shall serve upon the respondent a "Notice of Commencement of Legal Proceedings." The notice shall be served by certified mail to the registered agent of the respondent, or if there is no registered agent, then to any officer of the respondent. If there are no current officers of the respondent, service shall be upon the person or entity otherwise authorized by law to receive service of process. Service upon the general contractor shall be sufficient to initiate the process set forth in this section with regard to any builder or developer, if the builder or developer is not amenable to service of process by the foregoing methods. This notice shall toll all applicable statutes of limitation and repose, whether contractual or statutory, by and against all potentially responsible parties, regardless of whether they were named in the notice, including claims for indemnity applicable to the claim for the period set forth in subdivision (c). The notice shall include all of the following:

(1) The name and location of the project.

(2) An initial list of defects sufficient to apprise the respondent of the general nature of the defects at issue.

(3) A description of the results of the defects, if known.

(4) A summary of the results of a survey or questionnaire distributed to homeowners to determine the nature and extent of defects, if a survey has been conducted or a questionnaire has been distributed.

(5) Either a summary of the results of testing conducted to determine the nature and extent of defects or the actual test results, if that testing has been conducted.

(c) Service of the notice shall commence a period, not to exceed 180 days, during which the association, the respondent, and all other participating parties shall try to resolve the dispute through the processes set forth in this section. This 180-day period may be extended for one additional period, not to exceed 180 days, only upon the mutual agreement of the association, the respondent, and any parties not deemed peripheral pursuant to paragraph (3) of subdivision (e). Any extensions beyond the first extension shall require the agreement of all participating parties. Unless extended, the dispute resolution process prescribed by this section shall be deemed completed. All extensions shall continue the tolling period described in subdivision (b).

(d) Within 25 days of the date the association serves the Notice of Commencement of Legal Proceedings, the respondent may request in writing to meet and confer with the board of directors of the association. Unless the respondent and the association otherwise agree, there shall be not more than one meeting, which shall take place no later than 10 days from the date of the respondent's written request, at a mutually agreeable time and place. The meeting shall be subject to subdivision (b) of Section 1363.05. The discussions at the meeting are privileged communications and are not admissible in evidence in any civil action, unless the association and the respondent consent in writing to their admission.

(e) Upon receipt of the notice, the respondent shall, within 60 days, comply with the following:

(1) The respondent shall provide the association with access to, for inspection and copying of, all plans and specifications, subcontracts, and other construction files for the project that are reasonably calculated to lead to the discovery of admissible evidence regarding the defects claimed. The association shall provide the respondent with access to, for inspection and copying of, all files reasonably calculated to lead to the discovery of admissible evidence regarding the defects claimed, including all reserve studies, maintenance records and any survey questionnaires, or results of testing to determine the nature and extent of defects. To the extent any of the above documents are withheld based on privilege, a privilege log shall be prepared and submitted to all other parties. All other potentially responsible parties shall have the same rights as the respondent regarding the production of documents upon receipt of written notice of the claim, and shall produce all relevant documents within 60 days of receipt of the notice of the claim.

(2) The respondent shall provide written notice by certified mail to all subcontractors, design professionals, their insurers, and the insurers of any additional insured whose identities are known to the respondent or readily ascertainable by review of the project files or other similar sources and whose potential responsibility appears on the face of the notice. This notice to subcontractors, design professionals, and insurers shall include a copy of the Notice of Commencement of Legal Proceedings, and shall specify the date and manner by which the parties shall meet and confer to select a dispute resolution facilitator pursuant to paragraph (1) of subdivision (f), advise the recipient of its obligation to participate in the meet and confer or serve a written acknowledgment of receipt regarding this notice, advise the recipient that it will waive any challenge to selection of the dispute resolution facilitator if it elects not to participate in the meet and confer, advise the recipient that it may be bound by any settlement reached pursuant to subdivision (d) of Section 1375.05, advise the recipient that it may be deemed to have waived rights to conduct inspection and testing pursuant to

subdivision (c) of Section 1375.05, advise the recipient that it may seek the assistance of an attorney, and advise the recipient that it should contact its insurer, if any. Any subcontractor or design professional, or insurer for that subcontractor, design professional, or additional insured, who receives written notice from the respondent regarding the meet and confer shall, prior to the meet and confer, serve on the respondent a written acknowledgment of receipt. That subcontractor or design professional shall, within 10 days of service of the written acknowledgment of receipt, provide to the association and the respondent a Statement of Insurance that includes both of the following:

(A) The names, addresses, and contact persons, if known, of all insurance carriers, whether primary or excess and regardless of whether a deductible or self-insured retention applies, whose policies were in effect from the commencement of construction of the subject project to the present and which potentially cover the subject claims.

(B) The applicable policy numbers for each policy of insurance provided.

(3) Any subcontractor or design professional, or insurer for that subcontractor, design professional, or additional insured, who so chooses, may, at any time, make a written request to the dispute resolution facilitator for designation as a peripheral party. That request shall be served contemporaneously on the association and the respondent. If no objection to that designation is received within 15 days, or upon rejection of that objection, the dispute resolution facilitator shall designate that subcontractor or design professional as a peripheral party, and shall thereafter seek to limit the attendance of that subcontractor or design professional only to those dispute resolution sessions deemed peripheral party sessions or to those sessions during which the dispute resolution facilitator believes settlement as to peripheral parties may be finalized. Nothing in this subdivision shall preclude a party who has been designated a peripheral party from being reclassified as a nonperipheral party, nor shall this subdivision preclude a party designated as a nonperipheral party from being reclassified as a peripheral party after notice to all parties and an opportunity to object. For purposes of this subdivision, a peripheral party is a party having total claimed exposure of less than twenty-five thousand dollars ($25,000).

(f)(1) Within 20 days of sending the notice set forth in paragraph (2) of subdivision (e), the association, respondent, subcontractors, design professionals, and their insurers who have been sent a notice as described in paragraph (2) of subdivision (e) shall meet and confer in an effort to select a dispute resolution facilitator to preside over the mandatory dispute resolution process prescribed by this section. Any subcontractor or design professional who has been given timely notice of this meeting but who does not participate, waives any challenge he or she may have as to the

selection of the dispute resolution facilitator. The role of the dispute resolution facilitator is to attempt to resolve the conflict in a fair manner. The dispute resolution facilitator shall be sufficiently knowledgeable in the subject matter and be able to devote sufficient time to the case. The dispute resolution facilitator shall not be required to reside in or have an office in the county in which the project is located. The dispute resolution facilitator and the participating parties shall agree to a date, time, and location to hold a case management meeting of all parties and the dispute resolution facilitator, to discuss the claims being asserted and the scheduling of events under this section. The case management meeting with the dispute resolution facilitator shall be held within 100 days of service of the Notice of Commencement of Legal Proceedings at a location in the county where the project is located. Written notice of the case management meeting with the dispute resolution facilitator shall be sent by the respondent to the association, subcontractors and design professionals, and their insurers who are known to the respondent to be on notice of the claim, no later than 10 days prior to the case management meeting, and shall specify its date, time, and location. The dispute resolution facilitator in consultation with the respondent shall maintain a contact list of the participating parties.

(2) No later than 10 days prior to the case management meeting, the dispute resolution facilitator shall disclose to the parties all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed dispute resolution facilitator would be able to resolve the conflict in a fair manner. The facilitator's disclosure shall include the existence of any ground specified in Section 170.1 of the Code of Civil Procedure for disqualification of a judge, any attorney-client relationship the facilitator has or had with any party or lawyer for a party to the dispute resolution process, and any professional or significant personal relationship the facilitator or his or her spouse or minor child living in the household has or had with any party to the dispute resolution process. The disclosure shall also be provided to any subsequently noticed subcontractor or design professional within 10 days of the notice.

(3) A dispute resolution facilitator shall be disqualified by the court if he or she fails to comply with this paragraph and any party to the dispute resolution process serves a notice of disqualification prior to the case management meeting. If the dispute resolution facilitator complies with this paragraph, he or she shall be disqualified by the court on the basis of the disclosure if any party to the dispute resolution process serves a notice of disqualification prior to the case management meeting.

(4) If the parties cannot mutually agree to a dispute resolution facilitator, then each party shall submit a list of three dispute resolution facilitators. Each party may then strike one nominee from the other parties' list, and petition the court, pursuant to the

procedure described in subdivisions (n) and (o), for final selection of the dispute resolution facilitator. The court may issue an order for final selection of the dispute resolution facilitator pursuant to this paragraph.

(5) Any subcontractor or design professional who receives notice of the association's claim without having previously received timely notice of the meet and confer to select the dispute resolution facilitator shall be notified by the respondent regarding the name, address, and telephone number of the dispute resolution facilitator. Any such subcontractor or design professional may serve upon the parties and the dispute resolution facilitator a written objection to the dispute resolution facilitator within 15 days of receiving notice of the claim. Within seven days after service of this objection, the subcontractor or design professional may petition the superior court to replace the dispute resolution facilitator. The court may replace the dispute resolution facilitator only upon a showing of good cause, liberally construed. Failure to satisfy the deadlines set forth in this subdivision shall constitute a waiver of the right to challenge the dispute resolution facilitator.

(6) The costs of the dispute resolution facilitator shall be apportioned in the following manner: one-third to be paid by the association; one-third to be paid by the respondent; and one-third to be paid by the subcontractors and design professionals, as allocated among them by the dispute resolution facilitator. The costs of the dispute resolution facilitator shall be recoverable by the prevailing party in any subsequent litigation pursuant to Section 1032 of the Code of Civil Procedure, provided however that any nonsettling party may, prior to the filing of the complaint, petition the facilitator to reallocate the costs of the dispute resolution facilitator as they apply to any nonsettling party. The determination of the dispute resolution facilitator with respect to the allocation of these costs shall be binding in any subsequent litigation. The dispute resolution facilitator shall take into account all relevant factors and equities between all parties in the dispute resolution process when reallocating costs.

(7) In the event the dispute resolution facilitator is replaced at any time, the case management statement created pursuant to subdivision (h) shall remain in full force and effect.

(8) The dispute resolution facilitator shall be empowered to enforce all provisions of this section.

(g)(1) No later than the case management meeting, the parties shall begin to generate a data compilation showing the following information regarding the alleged defects at issue:

(A) The scope of the work performed by each potentially responsible subcontractor.

(B) The tract or phase number in which each subcontractor provided goods or services, or both.

(C) The units, either by address, unit number, or lot number, at which each subcontractor provided goods or services, or both.

(2) This data compilation shall be updated as needed to reflect additional information. Each party attending the case management meeting, and any subsequent meeting pursuant to this section, shall provide all information available to that party relevant to this data compilation.

(h) At the case management meeting, the parties shall, with the assistance of the dispute resolution facilitator, reach agreement on a case management statement, which shall set forth all of the elements set forth in paragraphs (1) to (8), inclusive, except that the parties may dispense with one or more of these elements if they agree that it is appropriate to do so. The case management statement shall provide that the following elements shall take place in the following order:

(1) Establishment of a document depository, located in the county where the project is located, for deposit of documents, defect lists, demands, and other information provided for under this section. All documents exchanged by the parties and all documents created pursuant to this subdivision shall be deposited in the document depository, which shall be available to all parties throughout the prefiling dispute resolution process and in any subsequent litigation. When any document is deposited in the document depository, the party depositing the document shall provide written notice identifying the document to all other parties. The costs of maintaining the document depository shall be apportioned among the parties in the same manner as the costs of the dispute resolution facilitator.

(2) Provision of a more detailed list of defects by the association to the respondent after the association completes a visual inspection of the project. This list of defects shall provide sufficient detail for the respondent to ensure that all potentially responsible subcontractors and design professionals are provided with notice of the dispute resolution process. If not already completed prior to the case management meeting, the Notice of Commencement of Legal Proceedings shall be served by the respondent on all additional subcontractors and design professionals whose potential responsibility appears on the face of the more detailed list of defects within seven days of receipt of the more detailed list. The respondent shall serve a copy of the case management statement, including the name, address, and telephone number of the dispute resolution facilitator, to all the potentially responsible subcontractors and design professionals at the same time.

(3) Nonintrusive visual inspection of the project by the respondent, subcontractors, and design professionals.

(4) Invasive testing conducted by the association, if the association deems appropriate. All parties may observe and photograph any testing conducted by the association pursuant to this paragraph, but may not take samples or direct testing unless, by mutual agreement, costs of testing are shared by the parties.

(5) Provision by the association of a comprehensive demand which provides sufficient detail for the parties to engage in meaningful dispute resolution as contemplated under this section.

(6) Invasive testing conducted by the respondent, subcontractors, and design professionals, if they deem appropriate.

(7) Allowance for modification of the demand by the association if new issues arise during the testing conducted by the respondent, subcontractor, or design professionals.

(8) Facilitated dispute resolution of the claim, with all parties, including peripheral parties, as appropriate, and insurers, if any, present and having settlement authority. The dispute resolution facilitators shall endeavor to set specific times for the attendance of specific parties at dispute resolution sessions. If the dispute resolution facilitator does not set specific times for the attendance of parties at dispute resolution sessions, the dispute resolution facilitator shall permit those parties to participate in dispute resolution sessions by telephone.

(i) In addition to the foregoing elements of the case management statement described in subdivision (h), upon mutual agreement of the parties, the dispute resolution facilitator may include any or all of the following elements in a case management statement: the exchange of consultant or expert photographs; expert presentations; expert meetings; or any other mechanism deemed appropriate by the parties in the interest of resolving the dispute.

(j) The dispute resolution facilitator, with the guidance of the parties, shall at the time the case management statement is established, set deadlines for the occurrence of each event set forth in the case management statement, taking into account such factors as the size and complexity of the case, and the requirement of this section that this dispute resolution process not exceed 180 days absent agreement of the parties to an extension of time.

(k)(1)(A) At a time to be determined by the dispute resolution facilitator, the respondent may submit to the association all of the following:

(i) A request to meet with the board to discuss a written settlement offer.

(ii) A written settlement offer, and a concise explanation of the reasons for the terms of the offer.

(iii) A statement that the respondent has access to sufficient funds to satisfy the conditions of the settlement offer.

(iv) A summary of the results of testing conducted for the purposes of determining the nature and extent of defects, if this testing has been conducted, unless the association provided the respondent with actual test results.

(B) If the respondent does not timely submit the items required by this subdivision, the association shall be relieved of any further obligation to satisfy the requirements of this subdivision only.

(C) No less than 10 days after the respondent submits the items required by this paragraph, the respondent and the board of directors of the association shall meet and confer about the respondent's settlement offer.

(D) If the association's board of directors rejects a settlement offer presented at the meeting held pursuant to this subdivision, the board shall hold a meeting open to each member of the association. The meeting shall be held no less than 15 days before the association commences an action for damages against the respondent.

(E) No less than 15 days before this meeting is held, a written notice shall be sent to each member of the association specifying all of the following:

(i) That a meeting will take place to discuss problems that may lead to the filing of a civil action, and the time and place of this meeting.

(ii) The options that are available to address the problems, including the filing of a civil action and a statement of the various alternatives that are reasonably foreseeable by the association to pay for those options and whether these payments are expected to be made from the use of reserve account funds or the imposition of regular or special assessments, or emergency assessment increases.

(iii) The complete text of any written settlement offer, and a concise explanation of the specific reasons for the terms of the offer submitted to the board at the meeting held pursuant to subdivision (d) that was received from the respondent.

(F) The respondent shall pay all expenses attributable to sending the settlement offer to all members of the association. The respondent shall also pay the expense of holding the meeting, not to exceed three dollars ($3) per association member.

(G) The discussions at the meeting and the contents of the notice and the items required to be specified in the notice pursuant to paragraph (E) are privileged communications and are not admissible in evidence in any civil action, unless the association consents to their admission.

(H) No more than one request to meet and discuss a written settlement offer may be made by the respondent pursuant to this subdivision.

(*l*) Except for the purpose of in camera review as provided in subdivision (c) of Section 1375.05, all defect lists and demands, communications, negotiations, and settlement offers made in the course of the prelitigation dispute resolution process provided by this section shall be inadmissible pursuant to Sections 1119 to 1124, inclusive, of the Evidence Code and all applicable decisional law. This inadmissibility shall not be extended to any other documents or communications which would not otherwise be deemed inadmissible.

(m) Any subcontractor or design professional may, at any time, petition the dispute resolution facilitator to release that party from

the dispute resolution process upon a showing that the subcontractor or design professional is not potentially responsible for the defect claims at issue. The petition shall be served contemporaneously on all other parties, who shall have 15 days from the date of service to object. If a subcontractor or design professional is released, and it later appears to the dispute resolution facilitator that it may be a responsible party in light of the current defect list or demand, the respondent shall renotice the party as provided by paragraph (2) of subdivision (e), provide a copy of the current defect list or demand, and direct the party to attend a dispute resolution session at a stated time and location. A party who subsequently appears after having been released by the dispute resolution facilitator shall not be prejudiced by its absence from the dispute resolution process as the result of having been previously released by the dispute resolution facilitator.

(n) Any party may, at any time, petition the superior court in the county where the project is located, upon a showing of good cause, and the court may issue an order, for any of the following, or for appointment of a referee to resolve a dispute regarding any of the following:

(1) To take a deposition of any party to the process, or subpoena a third party for deposition or production of documents, which is necessary to further prelitigation resolution of the dispute.

(2) To resolve any disputes concerning inspection, testing, production of documents, or exchange of information provided for under this section.

(3) To resolve any disagreements relative to the timing or contents of the case management statement.

(4) To authorize internal extensions of timeframes set forth in the case management statement.

(5) To seek a determination that a settlement is a good faith settlement pursuant to Section 877.6 of the Code of Civil Procedure and all related authorities. The page limitations and meet and confer requirements specified in this section shall not apply to these motions, which may be made on shortened notice. Instead, these motions shall be subject to other applicable state law, rules of court, and local rules. A determination made by the court pursuant to this motion shall have the same force and effect as the determination of a postfiling application or motion for good faith settlement.

(6) To ensure compliance, on shortened notice, with the obligation to provide a Statement of Insurance pursuant to paragraph (2) of subdivision (e).

(7) For any other relief appropriate to the enforcement of the provisions of this section, including the ordering of parties, and insurers, if any, to the dispute resolution process with settlement authority.

(*o*)(1) A petition filed pursuant to subdivision (n) shall be filed in the superior court in the county in which the project is located. The court shall hear and decide the petition within 10 days after

filing. The petitioning party shall serve the petition on all parties, including the date, time, and location of the hearing no later than five business days prior to the hearing. Any responsive papers shall be filed and served no later than three business days prior to the hearing. Any petition or response filed under this section shall be no more than three pages in length.

(2) All parties shall meet with the dispute resolution facilitator, if one has been appointed and confer in person or by the telephone prior to the filing of that petition to attempt to resolve the matter without requiring court intervention.

(p) As used in this section:

(1) "Association" shall have the same meaning as defined in subdivision (a) of Section 1351.

(2) "Builder" means the declarant, as defined in subdivision (g) of Section 1351.

(3) "Common interest development" shall have the same meaning as in subdivision (c) of Section 1351, except that it shall not include developments or projects with less than 20 units.

(q) The alternative dispute resolution process and procedures described in this section shall have no application or legal effect other than as described in this section.

(r) This section shall become operative on July 1, 2002, however it shall not apply to any pending suit or claim for which notice has previously been given.

(s) This section shall become inoperative on July 1, 2010, and as of January 1, 2011, is repealed, unless a later enacted statute, that is enacted before January 1, 2011, deletes or extends the dates on which it becomes inoperative and is repealed.

1375.1. (a) As soon as is reasonably practicable after the association and the builder have entered into a settlement agreement or the matter has otherwise been resolved regarding alleged defects in the common areas, alleged defects in the separate interests that the association is obligated to maintain or repair, or alleged defects in the separate interests that arise out of, or are integrally related to, defects in the common areas or separate interests that the association is obligated to maintain or repair, where the defects giving rise to the dispute have not been corrected, the association shall, in writing, inform only the members of the association whose names appear on the records of the association that the matter has been resolved, by settlement agreement or other means, and disclose all of the following:

(1) A general description of the defects that the association reasonably believes, as of the date of the disclosure, will be corrected or replaced.

(2) A good faith estimate, as of the date of the disclosure, of when the association believes that the defects identified in

paragraph (1) will be corrected or replaced. The association may state that the estimate may be modified.

(3) The status of the claims for defects in the design or construction of the common interest development that were not identified in paragraph (1) whether expressed in a preliminary list of defects sent to each member of the association or otherwise claimed and disclosed to the members of the association.

(b) Nothing in this section shall preclude an association from amending the disclosures required pursuant to subdivision (a), and any amendments shall supersede any prior conflicting information disclosed to the members of the association and shall retain any privilege attached to the original disclosures.

(c) Disclosure of the information required pursuant to subdivision (a) or authorized by subdivision (b) shall not waive any privilege attached to the information.

(d) For the purposes of the disclosures required pursuant to this section, the term "defects" shall be defined to include any damage resulting from defects.

1378. (a) This section applies if an association's governing documents require association approval before an owner of a separate interest may make a physical change to the owner's separate interest or to the common area. In reviewing and approving or disapproving a proposed change, the association shall satisfy the following requirements:

(1) The association shall provide a fair, reasonable, and expeditious procedure for making its decision. The procedure shall be included in the association's governing documents. The procedure shall provide for prompt deadlines. The procedure shall state the maximum time for response to an application or a request for reconsideration by the board of directors.

(2) A decision on a proposed change shall be made in good faith and may not be unreasonable, arbitrary, or capricious.

(3) Notwithstanding a contrary provision of the governing documents, a decision on a proposed change may not violate any governing provision of law, including, but not limited to, the Fair Employment and Housing Act (Part 2.8 (commencing with Section 12900) of Division 3 of Title 2 of the Government Code), or a building code or other applicable law governing land use or public safety.

(4) A decision on a proposed change shall be in writing. If a proposed change is disapproved, the written decision shall include both an explanation of why the proposed change is disapproved and a description of the procedure for reconsideration of the decision by the board of directors.

(5) If a proposed change is disapproved, the applicant is entitled to reconsideration by the board of directors of the association that made the decision, at an open meeting of the board. This paragraph

does not require reconsideration of a decision that is made by the board of directors or a body that has the same membership as the board of directors, at a meeting that satisfies the requirements of Section 1363.05. Reconsideration by the board does not constitute dispute resolution within the meaning of Section 1363.820.

(b) Nothing in this section authorizes a physical change to the common area in a manner that is inconsistent with an association's governing documents, unless the change is required by law.

(c) An association shall annually provide its members with notice of any requirements for association approval of physical changes to property. The notice shall describe the types of changes that require association approval and shall include a copy of the procedure used to review and approve or disapprove a proposed change.
