

Memorandum 2009-19

**Small Common Interest Developments
(Staff Draft Tentative Recommendation)**

In this study, the Commission is considering whether the law governing common interest developments (“CIDs”), should differentiate between different sizes of CIDs, in order to provide more appropriate governance rules for small CIDs.

As a first step in the study, the Commission is examining the procedures used to conduct a member election.

For the purposes of a tentative recommendation on this subject, the Commission has provisionally decided to define a “small” CID as one that has 50 or fewer separate interests. The Commission also directed the staff to prepare draft legislation, along the lines of the provision proposed on page 10 of CLRC Memorandum 2009-14. The draft legislation is attached, as part of a staff draft tentative recommendation.

The Commission will need to decide whether to approve the draft for public circulation, with or without changes.

Respectfully submitted,

Brian Hebert
Executive Secretary

CALIFORNIA LAW REVISION COMMISSION

STAFF DRAFT

TENTATIVE RECOMMENDATION

Small Common Interest Developments: Member Elections

April 2009

The purpose of this tentative recommendation is to solicit public comment on the Commission's tentative conclusions. A comment submitted to the Commission will be part of the public record. The Commission will consider the comment at a public meeting when the Commission determines what, if any, recommendation it will make to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made to it.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN July 1, 2009.

The Commission will often substantially revise a proposal in response to comment it receives. Thus, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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SUMMARY OF TENTATIVE RECOMMENDATION

The Law Revision Commission is conducting a study of whether the statutes governing common interest developments should differentiate between developments of different sizes, in order to provide simpler and more economical governance procedures for small associations.

As a first step, the Commission is recommending an optional in-person member election procedure for small associations. A small association would never be required to use the optional procedure.

The proposed in-person voting procedure would be simpler than the procedure provided under existing law, but would not compromise the core values served by the existing procedure: preservation of the secrecy of the ballot and protection against voter fraud.

This tentative recommendation was prepared pursuant to Resolution Chapter 100 of the Statutes of 2007.

SMALL COMMON INTEREST DEVELOPMENTS: MEMBER ELECTIONS

1 A common interest development (“CID”) is a real property development
2 characterized by (1) separate ownership of dwelling space (or a right of exclusive
3 occupancy) coupled with an undivided interest in common property, (2)
4 covenants, conditions, and restrictions that limit use of both the common area and
5 separate ownership interests, and (3) management of common property and
6 enforcement of restrictions by a community association. CIDs include
7 condominiums, community apartment projects, housing cooperatives, and planned
8 unit developments.¹

9 There are over 46,000 CIDs in California, with over 4.8 million total housing
10 units.² These developments comprise approximately one quarter of the state’s
11 housing stock.³ CIDs accounted for 60% of all residential construction starts
12 during the 1990s. The planned unit development alone represented more than 40%
13 of single family home sales during that period.⁴

14 CIDs are governed by volunteer directors, elected from among the unit owners.
15 Those volunteers face a complex array of responsibilities. They must maintain the
16 common property, budget for annual operating expenses and future maintenance
17 and replacement costs, assess and collect sufficient funds for those purposes,
18 conduct regular meetings of the board and the membership, and enforce the CID’s
19 rules and restrictions. All of those duties are governed by a complex body of law.⁵

20 In a large and well-financed community, the association can afford to hire
21 professional managers, accountants, and attorneys to assist with those
22 responsibilities. Those costs can be spread widely across the membership and
23 absorbed.

24 However, most CIDs are small, with limited resources. Half of all associations
25 have 25 units or fewer, with two-thirds of all associations having 50 units or
26 fewer.⁶ More than half of all associations have annual revenue of \$75,000 or less.⁷

1. See Civ. Code § 1351.

2. Levy & Erlanger, *2008 California Community Association Statistics* 1 (2008).

3. Gordon, *Planned Developments in California: Private Communities and Public Life* 20-21 (Cal. Pub. Policy Inst., 2004).

4. *Id.* at 3.

5. All CIDs are governed by the Davis-Stirling Common Interest Development Act. Civ. Code §§ 1351-1378. Most CIDs are also governed by some aspect of corporations law, typically the Nonprofit Mutual Benefit Corporation Law. See Corp. Code §§ 7110-8910. The overlap between those two sources of statutory law is extensive and potentially confusing.

6. Levy & Erlanger, *2008 California Community Association Statistics* 1 (2008). The cited figures are based on the 80% of CIDs for which the specified data is available.

7. *Id.*

1 It is difficult for these small communities to absorb and spread governance costs,
2 or to pay for professional assistance.

3 For that reason, it may be appropriate to provide simplified alternative
4 governance procedures for smaller CIDs, rather than continuing to use a one-size-
5 fits-all approach.

6 There are already some examples of size-based distinctions in CID law:

- 7 • Civil Code Section 1365(c) requires that an association with more than
8 \$75,000 in gross annual income have its financial statement reviewed by a
9 licensed accountant. An association with revenue below that threshold is not
10 required to have the financial statement reviewed.
- 11 • Civil Code Section 1365.9 provides limited tort immunity to owners of
12 separate interests in a CID, provided that the association maintains liability
13 insurance with a specified amount of coverage. The required amount
14 depends on whether the CID has 100 or fewer separate interests.
- 15 • Civil Code Section 1375(p)(3) exempts developments with fewer than 20
16 separate interests from special procedures that must be followed before
17 filing a complaint against a builder, developer, or general contractor based
18 on a claim for defects in design or construction of the CID.

19 The Law Revision Commission is studying whether there are other aspects of
20 CID law that should also be adjusted to provide simplified requirements for small
21 CIDs.

22 As a first step in this study, the Commission is examining the procedure for
23 conducting a member election. If there is support for simplification of the
24 procedure for small associations on that issue, the Commission will then consider
25 whether other aspects of CID governance might also benefit from similar
26 treatment.

27 DEFINITION OF “SMALL” CID

28 The first issue that must be addressed in this study is how to define a “small”
29 CID.

30 There are many measures that could be used in describing the size of a CID: the
31 number of separate interests in the development, the annual revenue of the
32 association, or some combination of factors.

33 In the proposed law, a “small” CID would be defined as a CID with 50 or fewer
34 separate interests.⁸ As discussed below, that method of defining “small” would be
35 simple, would provide certainty over time, and would relate directly to the
36 practicalities involved in conducting an election (because the operational
37 complexity of an election depends on the number of voters).

8. See proposed Civ. Code § 1363.08(c) *infra*.

1 **Simplicity**

2 One of the main premises of this study is that small CIDs often will not have the
3 resources to obtain professional advice and services. For that reason, the proposed
4 law should be drafted as simply as possible, to make it easier for owner-volunteers
5 to understand the law and how it affects them.

6 A definition of “small” that is based on the number of separate interests in the
7 development would be the simplest approach. The number of separate interests is
8 easily determined and is typically a fixed number that will not change over time.

9 By contrast, the use of annual income would be more complicated. The
10 association’s income may rise or fall over time, requiring that the association
11 periodically reassess its status under the law. There might also be some confusion
12 about what constitutes annual income for the purpose of the statutory definition.

13 Finally, any compound definition that turns on some combination of factors
14 would necessarily be more complex than a rule based on a single factor. The need
15 to specify whether a compound rule is logically conjunctive (i.e., income *and*
16 number of separate interests) or disjunctive (i.e., income *or* number of separate
17 interests), would add additional scope for misunderstanding.

18 **Certainty**

19 A definition of “small” that is based on the number of separate interests in a
20 development should provide certainty over time. It should be rare for separate
21 interests to be added to or subtracted from a development.

22 Such certainty over time would not exist if the definition of “small” was based
23 on an association’s annual income. Because an association’s annual income can
24 fluctuate over time, a CID with income that is close to the statutory threshold
25 would need to reevaluate its status repeatedly.

26 Another problem with an income-based standard is that the statutory dollar
27 threshold would need to be periodically adjusted by the Legislature, to reflect
28 inflation. If the Legislature made those adjustments, then the statute would be
29 changing over time, introducing another source of instability into the standard. If
30 the adjustments were not made, the statutory dollar threshold would become
31 obsolete.⁹

9. For example, as discussed above, Civil Code Section 1365(c) draws a distinction between associations that have annual income of \$75,000 or less, and associations with a larger annual income. That provision was added in 1985 and has not been adjusted since. See 1985 Cal. Stat. ch. 874, § 14. If adjusted for inflation, that amount would be \$150,000 in 2008, a 100% increase in value. U.S. Bureau of Labor Statistics Inflation Calculator <<http://data.bls.gov/cgi-bin/cpicalc.pl>>.

Instead of periodically amending the statute to account for inflation, another way to address inflation would be to include an automatic escalator in the statutory definition itself. However, that approach would add considerably to the complexity of the statute, as it would require regular recalculation of the adjusted dollar amount. One could not simply rely on the amount stated in the statute.

1 **Operational Scale**

2 The question of whether a CID is “small” and should therefore be treated
3 differently from larger CIDs, may depend on the subject matter at issue. For
4 example, with respect to accounting practices it might make sense to differentiate
5 between CIDs based on the size of their incomes.

6 In conducting a member election, however, it is the number of people voting in
7 the election that will determine the practicality of an election procedure. In a CID
8 with 6,000 members, bureaucratic voting procedures, with mailed ballots and
9 institutional safeguards against error or fraud, may be a practical necessity, despite
10 the cost inherent in such formalized procedures. By contrast, if 25 members
11 participate in an election, the most practical and efficient process might be to hold
12 the election in person, with the direct involvement of the members at all stages of
13 the process.

14 At least with respect to member elections, the number of separate interests in a
15 CID seems the best way to differentiate between the operational practicalities
16 involved in conducting “small” and “large” elections.

17 Annual income cannot be used reliably for that purpose, because of the wide
18 variability in the rate at which different CIDs assess their members. For example,
19 if the proposed law provided that a “small” CID is one with \$75,000 or less in
20 annual regular assessment income, the definition would encompass both a 25 unit
21 CID with monthly assessments of \$250 and a 625 unit CID with monthly
22 assessments of \$10.¹⁰ The practicalities involved in a 25 vote election are
23 qualitatively different from the practicalities involved in a 625 vote election. An
24 income-based definition would not distinguish between the two.

25 **PROBLEMS WITH EXISTING ELECTION PROCEDURE**

26 Civil Code Section 1363.03 provides a detailed procedure that must be used in
27 carrying out specified types of member elections.¹¹ That procedure seems well-
28 suited to a mail-in election in a large association, where it protects ballot secrecy
29 and provides institutional safeguards against fraud. However, the procedure does
30 present some problems, especially for a small CID.

31 **Overview of Existing Procedure**

32 In general terms, the existing statutory election procedure requires all of the
33 following:

10. For an example of a 170 unit CID with monthly assessments of \$8.33, see First Supplement to Commission Staff Memorandum 2009-14, Exhibit pp. 13 (Feb. 4, 2009).

11. Section 1363.03 specifies the procedure for an election to approve an assessment, choose or remove a director, amend the governing documents, or grant exclusive use of common area property. See Civ. Code § 1363.03(b).

- 1 (1) *Association selects election inspectors.* The association must select one or
2 three independent election inspectors to oversee the election. The election
3 inspectors determine who is eligible to vote, determine the authenticity of
4 proxies, receive ballots, authenticate ballots, count ballots, and report the
5 results of the election. Election inspectors also hear and decide challenges or
6 questions relating to voting rights.¹²
- 7 (2) *Association prepares and distributes ballots.* At least 30 days before the
8 election date, the association must prepare and distribute ballots to all
9 members who are entitled to vote. A ballot must not be marked in any way
10 that would identify the member who casts it. Along with the ballot, the
11 association must provide two envelopes, an inside envelope and an outside
12 envelope.¹³
- 13 (3) *Member casts ballot.* The member marks the ballot to indicate a vote and
14 then seals it within the inside envelope. The inside envelope bears no marks
15 that would identify the member. The inside envelope is then sealed into the
16 outside envelope. The member signs the outside envelope and writes the
17 member's name and address in the upper left hand corner. The outside
18 envelope is then addressed to the election inspector. The member may either
19 hand deliver the ballot or mail it.¹⁴ However, the association has the option
20 of requiring that *all* ballots be mailed.¹⁵
- 21 (4) *Election inspectors tabulate votes.* The election inspectors count and
22 tabulate the votes at an open board meeting or member meeting, which any
23 member can attend to observe the process.¹⁶

24 Problems resulting from that procedure are discussed below. Problems that
25 apply to all CIDs are discussed first, than problems that are unique to small CIDs,
26 or especially acute in that context.

27 **Risk of Identity Theft**

28 Existing law requires that a person casting a ballot sign the outside envelope
29 before delivering the ballot. That creates a risk of identity theft, because a person
30 handling the envelope has both the address and a signature sample of the person
31 who cast the ballot.

32 **Problems with Differential Voting Power**

33 In most associations, a member may be able to cast more than one vote. For
34 example, it is common for a CID owner to cast one vote for each separate interest
35 that the person owns. In some CIDs, the number of votes cast by owners depends

12. Civ. Code § 1363.03(c).

13. Civ. Code § 1363.03(e).

14. *Id.*

15. Civ. Code § 1363.03(k).

16. Civ. Code § 1363.03(f)-(g).

1 on the square footage of the owner's separate interest or some other measure of
2 relative value.

3 Under the existing double-envelope system, there is no efficient way for an
4 owner to cast multiple ballots. Because the ballot is not permitted to identify the
5 voter in any way, it cannot be marked to indicate differential voting power.
6 Similarly, a single inside envelope could not be used to contain multiple ballots,
7 because there would be no way to confirm that the person casting those ballots is
8 entitled to cast multiple ballots. The inside envelope is sealed and cannot contain
9 any marks that might identify the voter.

10 This seems to require that a voter complete a separate ballot for every vote cast,
11 with each ballot sealed in its own set of separately delivered double envelopes.

12 That adds significant cost and burden to the voting process when a single owner
13 may cast multiple ballots.

14 **Problems with Proxies**

15 In some associations, a proxy may be given to allow one member to cast the
16 vote of another member, on the proxy-giver's behalf. The use of proxies is often
17 critical in achieving a quorum for an election.

18 A proxy may grant general discretion to the proxy-holder as to how to vote the
19 ballot, or it may include specific direction on how the proxy-holder is to vote the
20 ballot.

21 In evaluating a proxy, an election inspector would need to authenticate the
22 identity and voting power of the person who gave the proxy, determine whether
23 the proxy is general or directed, and then confirm that the ballot cast by the proxy-
24 holder actually conforms to the authority granted by the proxy.

25 There does not seem to be any lawful way to accomplish those tasks under the
26 existing double-envelope procedure. If the proxy form is *outside* of the sealed
27 ballot envelope, the election inspector could authenticate the proxy, but could not
28 determine whether the ballot conforms to the authority given by the proxy. If the
29 proxy is contained *inside* the sealed ballot envelope, the election inspector could
30 check whether the ballot conforms to the proxy, but could not confirm that the
31 person casting the ballot was the person authorized under the proxy.

32 It seems inevitable that the use of proxies, which is often necessary in achieving
33 a quorum, will result in technical violations of the statutory procedure, which
34 could result in spoiled ballots or provide the basis for a judicial challenge of the
35 election's validity.

36 **Problems Applying Existing Procedure to Small CIDs**

37 In addition to the general problems described above, the existing statutory
38 procedure seems to be a poor fit for small CIDs.

39 First, the existing procedure seems unnecessarily formal when conducting an
40 election on a small scale. The policy goals of the statutory procedure are to ensure
41 the secrecy of the ballot and the transparency and integrity of the voting process.

1 In a small CID, those goals could be achieved using a much simpler in-person
2 voting procedure, with the members directly participating in and observing every
3 step of the voting process.

4 Second, the cost of the statutory procedure could be unduly burdensome for a
5 small association. Suppose that an independent election inspector charges \$500 to
6 oversee an election.¹⁷ In an association with 500 units, the pro rata cost of \$1 per
7 unit would be easily absorbed. But in an association with 5 units, the burden of a
8 \$100 per unit cost would outweigh the benefit of having an independent inspector
9 count five ballots.¹⁸

10 Finally, it is inevitable that some small associations will be ignorant of the law
11 or will ignore it on the grounds that it seems unrealistically costly and
12 cumbersome. Elections in those associations would be subject to legal challenge.
13 All of the actions of a board elected in violation of the procedure could be
14 challenged as invalid.

15 PROPOSED LAW

16 The Commission recommends that the law provide a simplified procedure
17 for small associations that meets all of the following goals:

- 18 (1) *Secrecy.* The procedure should not compromise the existing guarantee of
19 secrecy of the ballot.
- 20 (2) *Procedural transparency.* The procedure should allow members to directly
21 observe all stages of the process, as a check against error or fraud.
- 22 (3) *Reduced cost and complexity.* The procedure should be simpler and less
23 expensive than the procedure provided under existing law.
- 24 (4) *Optional.* Some associations may prefer to use the more complex procedure
25 provided in existing law. That option should be preserved.
- 26 (5) *Validation of common-sense practices.* Many owners in small associations
27 may be unaware of governing statutory law. The new procedure should be
28 designed to conform to common-sense practices, so that an association that
29 acts reasonably and in good faith would have a significant chance of
30 complying with the law by default.
- 31 (6) *Preserve existing rules on campaigning and judicial review.* Existing law
32 provides rules for use of association funds for campaign purposes¹⁹ and

17. There is no statutory requirement that an election inspector be paid for the services provided. However, given the significant responsibilities and potential liabilities of an election inspector, and the requirement that the election inspector have a degree of independence akin to that of a county poll worker, licensed accountant, or notary public, it seems likely that most election inspectors will charge for their services. See Civ. Code § 1363.03(c)(2).

18. If the proposed law allowed each small association to avoid \$500 per year in election costs, the annual savings statewide would exceed \$15 million.

19. Civ. Code § 1363.04.

1 judicial review of a member election.²⁰ Those provisions do not impose any
2 procedural burden on an association and should continue to be applicable to
3 a small association.

4 The proposed law would accomplish all of those goals, by providing an optional
5 in-person voting procedure for use by small CIDs.²¹ In-person voting is feasible
6 when conducting a small election, because all of the owners could easily meet to
7 directly participate in the election process. (In many cases, an owner who cannot
8 attend an election meeting could still participate by proxy.)

9 The proposed in-person procedure would also avoid the problems associated
10 with the existing statutory procedure:

11 **Identity Theft**

12 If ballots are cast in person, there would be no need for a signature on the
13 outside of an envelope. The risk of identity theft based on such a signature would
14 be eliminated.

15 **Differential Voting Power**

16 In-person voting would also avoid any problem relating to differential voting
17 power. The right of a person to cast multiple ballots could be confirmed in person,
18 and that voter could be given multiple ballots to mark and place in the ballot box.

19 **Proxies**

20 The voting of proxies should be problem free when conducting an in-person
21 election. The proxy could be confirmed in person, with the proxy-holder given an
22 additional ballot to cast pursuant to the proxy. If the proxy directs how the ballot
23 should be cast, compliance with that direction could be confirmed before the ballot
24 is placed in the ballot box.²²

25 **Other Benefits**

26 In a small election, conducted using in-person voting, the cost and
27 inconvenience of employing an independent election inspector could be avoided.
28 There is no need for a third party to oversee an election if all of the members can
29 directly observe and participate in the process of confirming voter eligibility and
30 proxy validity, casting secret ballots, and tabulating the results of the election.

31 In addition, because the proposed procedure is simple and intuitive, it seems
32 likely that many small and informally run CIDs would comply with the procedure
33 even if unaware of the law. This will help to avoid problems in small associations

20. Civ. Code § 1363.09.

21. See proposed Civ. Code § 1363.08 *infra*.

22. By giving a directed proxy, a person necessarily waives secrecy. In order to confirm that the proxy is properly carried out, the identity and instructions of the person giving the ballot must be disclosed.

- 1 that act reasonably and in good faith, but are ignorant of the specific requirements
- 2 of statutory law.

PROPOSED LEGISLATION

1 **Civ. Code § 1368.08 (added). In-person voting in small CID**

2 SECTION 1. Section 1363.08 is added to the Civil Code, to read:

3 1363.08. (a) A small common interest development may choose to conduct a
4 member election under this section, rather than under Section 1363.03. A member
5 election conducted under this section is governed by Sections 1363.04 and
6 1363.09.

7 (b) A member election conducted under this section shall substantially comply
8 with all of the following requirements:

9 (1) Notice of the election shall be provided to each member at least 30 days
10 before the meeting at which the election is held. The notice shall state the time and
11 place at which the meeting will be held. The notice shall describe the matters that
12 will be decided in the election.

13 (2) The election shall be held at a meeting of the members at which a quorum is
14 present. If the governing documents permit the use of a proxy, a proxy may be
15 counted in determining the quorum.

16 (3) A candidate for elected office may be nominated prior to the election or at
17 the meeting at which the election is held.

18 (4) Votes shall be cast by secret written ballot, except as may be necessary to
19 cast a ballot pursuant to a proxy. A vote may be cast for a write-in candidate.

20 (5) After all of the members present have had an opportunity to vote, the ballots
21 shall be counted openly, at the meeting at which they were cast. The vote totals
22 and results of the election shall be announced at the meeting.

23 (6) If a vote to elect directors or other officers results in a tie, and a quorum is
24 still present when the tie is announced, the members present at the meeting may
25 act immediately to attempt to break the tie. Unless the governing documents
26 provide another method, a run-off election between the tied candidates shall be
27 used to attempt to break the tie.

28 (c) As used in this section “small common interest development” means a
29 common interest development with 50 or fewer separate interests.

30 **Comment.** Section 1363.08 is new. It provides an optional alternative member election
31 procedure for use by a “small common interest development” (as defined in subdivision (c)). A
32 small common interest development is never required to conduct an election pursuant to this
33 section. An election that is not conducted under this section may be governed by Section 1363.03.