Study H-855 November 23, 2010

Memorandum 2010-57

Common Interest Development: Statutory Clarification and Simplification of CID Law (Comments on Governance Provisions)

This memorandum continues the analysis and discussion of the public comments received on the Commission's tentative recommendation on *Statutory Clarification and Simplification of CID Law* (Feb. 2010). It addresses comments on the association governance provisions of the proposed law.

For the most part, the Comments discussed in this memorandum are set out in the Exhibit to Memorandum 2010-36. However, we have recently received two more comment letters, which are attached in the Exhibit as follows:

Because of the large number of comments and the importance of completing review of those comments before the end of this year, if possible, this memorandum employs a practice that the Commission sometimes uses to expedite review of voluminous material — issues that appear to require Commission discussion at the meeting are marked with the "☞" symbol in the heading for that issue.

All other issues in the memorandum are presumed to be noncontroversial "consent" items, that are deemed approved without discussion. *That is only a presumption, and Commissioners and members of the public will have an opportunity to discuss those issues at the meeting, if discussion is needed.*

Where this memorandum sets out a provision of the proposed law, the text includes any changes that were made at prior meetings.

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

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.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting.

REVIEW OF METHODOLOGY

The goal of the current study is to reorganize and, to a lesser extent, restate the Davis-Stirling Common Interest Development Act ("Davis-Stirling Act"), in order to make it easier to understand and use. In addition, some uncontroversial substantive improvements will be proposed.

Recent Commission experience makes clear that a project of this type becomes more difficult to enact the more it strays from the letter and substance of existing law.

Every deviation from existing language carries the potential for an unintended change in meaning. Even an arguable change in meaning may be problematic, to the extent that it produces uncertainty, disagreement, or litigation.

Every substantive change could give rise to opposition to the proposed law as a whole. Even if no objections are raised during the Commission's process, such objections can arise in the legislative process, greatly complicating the process and prospect of enactment of the proposed law.

For those reasons, the Commission has adopted a conservative approach in drafting and evaluating the proposed law. Specifically, it decided on the following methodology:

(1) Noncontroversial substantive improvements will be retained.
(2) Changes in wording that are necessary to clarify unclear language in existing law will be retained.
(3) Improvements to the structural organization of the Davis-Stirling Common Interest Development Act will be retained.
(4) The attempt to integrate applicable elements of the Corporations Code into the Davis-Stirling Common Interest Development Act will be abandoned. Where appropriate, cross-references to relevant provisions of the Corporations Code may be added to the proposed law, in statutory or Comment language.
(5) The general attempt to make the language of existing law simpler and easier to understand will be abandoned. But see (2) above.

Minutes (April 2009), p. 3.

When points (2) and (5) are read together, the result is that the Commission will propose changes to existing language only where necessary to cure ambiguous or confusing language. *Minor stylistic improvements, however meritorious, will not be made.* This last point has been emphasized in order to provide context for the staff recommendations in this memorandum. There are

many instances where the staff has recommended against making a change to language because the change does not meet the high bar described above (i.e., the change is not strictly necessary in order to cure an ambiguity or avoid misunderstanding). The staff recognizes that many of these proposed changes would be stylistic improvements. In another context, the staff would recommend that they be made.

It is only because of the practical difficulties involved in enactment of a large recodification proposal, which the Commission sought to minimize through its conservative methodology, that the staff is recommending against making these types of changes. The staff regrets the missed opportunity, but believes that the Commission's approach is the right one. As regrettable as it is to reject thoughtful and meritorious suggestions for improvement, it would be even more regrettable to include them in the proposal and have it sink under the weight of generalized concern that "too many language changes were made."

OLD BUSINESS

There are a few issues that were not fully resolved at the October meeting or that expand on issues that were raised in prior memoranda. They are discussed below.

☞ Definition of "Member"

Proposed Section 4160(b) would include within the definition of "member," the following types of "persons":

> A person that is designated as a member in the declaration, articles of incorporation, or bylaws. The incidents of a membership established under this paragraph may be limited by the document that establishes the membership.

This was proposed because there are associations that grant limited membership rights to non-owners. In these cases, the Davis-Stirling Act should treat such persons as "members" (e.g., if a person has the substantive voting rights of a "member," then they should be treated in the same way as other members for the purposes of statutory election procedure).

Unfortunately, the proposed language is probably not clear enough in drawing a connection between the *substantive* membership rights conferred by the governing documents and the commensurate *procedural* treatment under the Davis-Stirling Act.

Having thought about the issue further, **the staff now recommends dropping the new language entirely.** If the governing documents confer substantive rights on a non-owner, those documents can also define whatever procedures are required to implement them. For example, the governing documents could provide that a person "has a right to vote and shall be treated in the same way as any other member for the purposes of meeting and election procedures."

Because this issue is created by privately drafted agreements, which could exist in a multiplicity of forms, it would be very difficult to draft a one-size-fits-all statutory standard that would not create problems when applied to unanticipated cases. It would be better to leave the matter to be resolved privately, with the parties adopting whatever language suits their particular needs.

☞ Definition of "Recording"

In a prior memorandum, the staff raised the possibility of adding a definition of "recording," to provide guidance for Davis-Stirling Act users who might not know the meaning of the term, thus:

> If a provision of this Act provides that a document shall or may be "recorded," that document shall be filed for record in the office of the county recorder of each county in which any portion of the common interest development is located.

See Memorandum 2010-47, pp. 41-42.

The Commission had two concerns about that language:

(1) The terms "shall" and "may" should be adjusted to avoid any confusion about when recording is mandatory.
(2) The requirement that a document be recorded in each county in which a CID is located may be inappropriate in some circumstances (e.g., when recording a lien on an individual separate interest, rather than the CID as a whole).

Those problems could perhaps be avoided by recasting the provision to read as follows:

> For the purposes of this Act, "recording" a document means to file the document for record in the office of the county recorder. If a document affects property that is located in more than one county, it shall be recorded in each county in which the affected property is located.

The staff is still not entirely sure about the second sentence of that language. Even a document that only affects a single separate interest (e.g., a notice of delinquent assessment), also affects the owner's appurtenant interest in the common area. If that common area straddles a county line, would the proposed language require that the notice be recorded in both counties?

It might be best just to drop the provision. While it would be helpful to provide readers with some guidance on recording requirements, that should not be done in a way that creates new questions.

☞ **Definition of Operating Rule**

At the October 2010 meeting, the Commission decided to revise the definition of "operating rule" along the following lines:

> 4165. "Operating rule" means a regulation adopted by the board that applies ~~generally to the management and operation of the common interest development or the conduct of the business and affairs of the association~~ to a matter listed in subdivision (a) of Section 4355.

After further consideration, the staff sees a potential problem with the proposed revision.

Under existing law, the defined term "operating rule" is used in two contexts:

(1) In Section 1357.110 (continued in proposed Section 4350), which establishes general standards for the legal validity of an operating rule (e.g., to be valid and enforceable, an operating rule must be reasonable, consistent with governing law, and consistent with the governing documents).
(2) In Section 1357.120 (continued in proposed Section 4355), which provides a rulemaking procedure to be used in adopting or amending specified types of operating rules.

In proposed Section 4350, a broad definition of "operating rule" is unproblematic. The principles governing the validity of an operating rule are salutary and should be applied broadly to all board-adopted regulations.

In proposed Section 4355, the scope of the rulemaking procedure is intentionally limited to specified types of operating rules — those that have a significant effect on member rights and association-member relations. This reflects a policy choice that member participation in rulemaking should only be required where a rule would affect the members' rights directly.

If the definition of "operating rule" were revised to parallel the limitations stated in proposed Section 4355, it would also limit the scope of proposed Section 4350. That would narrow the application of the general standards that govern the validity of an operating rule. The staff sees no good policy reason to narrow the scope of proposed Section 4350 in that way.

Consequently, the staff recommends against narrowing the definition. Another alternative would be to move the definition of "operating rule" to the article governing operating rules (proposed Section 4350 *et seq*.) and limit its application to that article. That would continue the existing limited application of the definition. This would avoid the risk that generalization of the definition might inadvertently broaden other provisions that use the term "operating rule." **The staff recommends this approach, which would preserve existing law.**

Amendment of Declaration to Extend its Term

On page 20 of Memorandum 2010-48, the staff recommends revising proposed Section 4265(a) to standardize language relating to member approval of an amendment of the declaration, thus:

> The Legislature further finds and declares that it is in the public interest to provide a vehicle for extending the term of the declaration if ~~members having more than 50 percent of the votes in the association choose to do so~~ approved by a majority of all members.

Sun City Roseville Community Association ("Sun City Roseville") writes to suggest a slight adjustment to the proposed revision. They would add "pursuant to Section 4065" to the end of the inserted language. See Exhibit p. 3. That would be more consistent with drafting used elsewhere in the proposed law and would not introduce any new substantive change. **The staff recommends that the change be made.**

Rulemaking

Sun City Roseville raises three points relating to proposed Section 4365, which provides a procedure for member reversal of an operating rule change. See Exhibit p. 3. The staff has already recommended fairly extensive revisions to that section. See Memorandum 2010-48, pp. 33-35. Sun City Roseville's points are as follows:

(1) Proposed Section 4365(a) should be revised as follows:

> Members of an association ~~owning~~ representing five percent or more of the separate interests may call a special meeting of the members to reverse a rule change.

Given the conservative drafting approach being used in this study, the staff recommends against making the change. It is not necessary to correct a defect or eliminate a significant source of confusion.

(2) Why does the section refer to "Article 4 (commencing with Section 5100)," rather than "Section 5100 *et seq*."? The answer is that the reference format follows the established statutory drafting style.

(3) Is proposed Section 4365(e) necessary, given the fact that it is similar in effect to proposed Section 5140 (relating to member voting power)? As discussed below, under "Voting Rights and Joint Ownership," the staff is recommending the deletion of proposed Section 5140. That would eliminate the overlap noted by Sun City Roseville.

ASSOCIATION EXISTENCE AND POWERS

Existence of Association

Proposed Section 4800 would continue existing Section 1363(a) without change, thus:

> 4800. A common interest development shall be managed by an association that may be incorporated or unincorporated. The association may be referred to as a community association.

Duncan McPherson suggests that the Davis-Stirling Act leaves open the question of whether an association can exist without a managing association, because the existence of the association is not a prerequisite to formation of a CID under proposed Section 4030 (renumbered by the Commission as proposed Section 4200). See Memorandum 2010-36, Exhibit p. 68.

Regardless of whether the existence of a governing association is a prerequisite to formation, it is clear that Section 4800 states a mandatory requirement. Once the CID exists, it must have an association. **To the extent that there is an unresolved "chicken and egg" issue regarding the legal existence of the CID and its managing association, that issue could be addressed in a separate study of formation issues.**

A working group of the California State Bar Real Property Law Section ("RPLS Working Group") writes to suggest that proposed Section 4800 be revised to broaden the alternative names that may be used in referring to an association, thus:

> 4800. A common interest development shall be managed by an association that may be incorporated or unincorporated. The association may be referred to as an association, an owners' association, or a community association.

They suggest that this would better reflect actual practice. See Memorandum 2010-36, Exhibit p. 147.

Plainly, it is proper to call the association an "association." That is the existing usage in the Davis-Stirling Act. Use of the term "community association" is also already authorized. So the only question is whether use of the term "owners' association" should be authorized.

The staff sees no problem that could result from authorizing use of the term. The meaning of "association" is fixed by statute and would not be changed by authorizing the use of an alternative name.

In fact, the proposed change would probably be helpful. There are already other statutes that refer to a CID's association as an "owners' association." See, e.g., Bus. & Prof. Code § 11004.5(h)(2); Corp. Code § 8724. Express authorization of that variant term would help to avoid confusion. **The staff recommends that the change be made.**

Unincorporated Association

Proposed Section 4805 would continue existing Section 1363(c) without substantive change, thus:

> 4805. (a) Unless the governing documents provide otherwise, and regardless of whether the association is incorporated or unincorporated, the association may exercise the powers granted to a nonprofit mutual benefit corporation, as enumerated in Section 7140 of the Corporations Code, except that an unincorporated association may not adopt or use a corporate seal or issue membership certificates in accordance with Section 7313 of the Corporations Code.
>
> (b) The association, whether incorporated or unincorporated, may exercise the powers granted to an association in this Act.

The RPLS Working Group suggests revising subdivision (a) to expressly provide that an *unincorporated* association may bring an action under

Corporations Code Section 7515 (which permits a court to modify the procedures for amendment of governing documents in appropriate circumstances). The RPLS Working Group believes that this would "clarify" the law rather than make a substantive change, because subdivision (a) already provides that an unincorporated association "may exercise the powers of an incorporated association under the Nonprofit Mutual Benefit Corporation Law." See Memorandum 2010-36, Exhibit p. 135.

It is not clear to the staff that subdivision (a) has such a broad effect. Proposed Section 4805(a) grants an unincorporated association the powers enumerated in Corporations Code Section 7140, which reads:

> 7140. Subject to any limitations contained in the articles or bylaws and to compliance with other provisions of this division and any other applicable laws, a corporation, in carrying out its activities, shall have all of the powers of a natural person, including, without limitation, the power to:
>
> (a) Adopt, use, and at will alter a corporate seal, but failure to affix a seal does not affect the validity of any instrument.
>
> (b) Adopt, amend, and repeal bylaws.
>
> (c) Qualify to conduct its activities in any other state, territory, dependency or foreign country.
>
> (d) Issue, purchase, redeem, receive, take or otherwise acquire, own, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own memberships, bonds, debentures, notes and debt securities.
>
> (e) Pay pensions, and establish and carry out pension, deferred compensation, saving, thrift and other retirement, incentive and benefit plans, trusts and provisions for any or all of its directors, officers, employees, and persons providing services to it or any of its subsidiary or related or associated corporations, and to indemnify and purchase and maintain insurance on behalf of any fiduciary of such plans, trusts, or provisions.
>
> (f) Issue certificates evidencing membership in accordance with the provisions of Section 7313 and issue identity cards.
>
> (g) Levy dues, assessments, and admission and transfer fees.
>
> (h) Make donations for the public welfare or for community funds, hospital, charitable, educational, scientific, civic, religious or similar purposes.
>
> (i) Assume obligations, enter into contracts, including contracts of guarantee or suretyship, incur liabilities, borrow or lend money or otherwise use its credit, and secure any of its obligations, contracts or liabilities by mortgage, pledge or other encumbrance of all or any part of its property and income.
>
> (j) Participate with others in any partnership, joint venture or other association, transaction or arrangement of any kind whether

or not such participation involves sharing or delegation of control with or to others.

(k) Act as trustee under any trust incidental to the principal objects of the corporation, and receive, hold, administer, exchange, and expend funds and property subject to such trust.

(*l*) Carry on a business at a profit and apply any profit that results from the business activity to any activity in which it may lawfully engage.

Nothing in that enumeration of powers plainly authorizes the use of the special judicial amendment procedure provided in Corporations Code Section 7515. It is therefore unclear to the staff whether the proposed revision would be a clarification of existing law or a substantive change in the law. Resolution of that issue would require more research and analysis than is appropriate in the context of the current study. **The matter should be noted for possible future study.**

Association Standing

Proposed Section 4810 would continue existing Section 1368.3 without substantive change, thus:

> 4810. An association established to manage a common interest development has standing to institute, defend, settle, or intervene in litigation, arbitration, mediation, or administrative proceedings in its own name as the real party in interest and without joining with it the members, in matters pertaining to the following:
>
> (a) Enforcement of the governing documents.
>
> (b) Damage to the common area.
>
> (c) Damage to a separate interest that the association is obligated to maintain or repair.
>
> (d) Damage to a separate interest that arises out of, or is integrally related to, damage to the common area or a separate interest that the association is obligated to maintain or repair.

Duncan McPherson suggests deleting the words "established to manage a common interest development" in the first sentence. See Memorandum 2010-36, Exhibit p. 68. **The staff agrees that the language is unnecessary and should be deleted.** The language is a holdover from a time when the existing provision was located outside of the Davis-Stirling Act and was therefore not governed by the definition of the term "association." See former Code Civ. Proc. § 383; 1993 Cal. stat. ch. 151.

Location of Proposed Sections 4810 and 4815

The RPLS Working Group suggests relocating proposed Sections 4810 (discussed above) and 4815 (providing special rules on comparative fault in specified actions involving an association), to proposed Article 4 (Civil Actions) of Chapter 8 (Dispute Resolution and Enforcement).

That is a good suggestion. The proposed location would seem to be a better organizational fit for the provisions than their current location. Proposed Section 4815 in particular has little connection to its present location (other than its relationship to proposed Section 4810). **The staff recommends that the change be made.**

Joint Neighborhood Association

Proposed Section 4820 would continue existing Section 1363(i) without change, thus:

> 4820. Whenever two or more associations have consolidated any of their functions under a joint neighborhood association or similar organization, members of each participating association shall be (1) entitled to attend all meetings of the joint association other than executive sessions, (2) given reasonable opportunity for participation in those meetings, and (3) entitled to the same access to the joint association's records as they are to the participating association's records.

Duncan McPherson notes that a "joint neighborhood association" might itself not be a CID, in which case it would not be an "association" as that term is defined in the Davis-Stirling Act. That could be confusing. See Memorandum 2010-36, Exhibit p. 68. However, proposed Section 4820 also refers to any "other similar organization." This seems to create enough flexibility to encompass entities other than an "association." **For that reason, the staff does not recommend making any revision to address the issue.**

BOARD MEETINGS

Notice of Board Meeting

Proposed Section 4920 would read:

> 4920. (a) Unless the time and place of meeting is fixed by the governing documents, or unless the governing documents provide for a longer period of notice, members shall be given notice of the time and place of a board meeting, except for an emergency

meeting held pursuant to Section 4923, at least four days prior to the meeting. Notice shall be given by general delivery pursuant to Section 4045. The notice shall contain the agenda for the meeting.

(b) If the association is organized as a nonprofit mutual benefit corporation, notice of a board meeting is also governed by Section 7211 of the Corporations Code.

We received a number of comments about this provision.

☞ *Fixed Schedule Exception*

Kazuko K. Artus suggests deleting the first clause of the provision, which appears to dispense with the notice requirement if the time and place of board meetings is fixed by the governing documents (hereafter the "fixed schedule exception"). She argues that this fixed schedule exception is incompatible with a later added provision, which limits the business considered by a board at a board meeting to the matters listed in the meeting agenda that is included with the meeting notice (hereafter the "agenda content limitation"). See Memorandum 2010-36, Exhibit p. 56. With exceptions not relevant here, the agenda content limitation reads as follows:

> [The] board may not discuss or take action on any item at a nonemergency meeting unless the item was placed on the agenda included in the notice that was distributed pursuant to subdivision (a) of Section 4920.

Proposed Section 4930(a)

Under Ms. Artus' reading of the provisions, the Legislature should have deleted the fixed schedule exception when it added the agenda content limitation, but apparently overlooked the inconsistency between the two rules. Deletion of the fixed schedule limitation would then be necessary to fully effectuate the policy of the agenda content limitation.

However, there is another possible reading of the two provisions. One could read proposed Section 4930(a) as only imposing the agenda content limitation *to the extent that a notice is required.* Under that reading, there is no inconsistency between the two provisions.

As a matter of policy, the staff does not see any compelling reason that an association with a fixed meeting schedule should be permitted to circumvent the agenda content limitation. Established policy requires that associations provide their members advance notice of the business that will be discussed at a board meeting. This helps members know which board meetings will address matters

of particular concern to them. The fact that the time and location of the meeting are fixed in advance, doesn't seem relevant to the purpose of the agenda content limitation.

However, the proposed change could be controversial. **The issue requires discussion.**

Enforcement

Ms. Artus also suggests providing a more effective remedy for violation of the notice requirements. She suggests adding a provision invalidating a decision made at a meeting held in violation of the meeting notice requirements. See Memorandum 2010-36, Exhibit p. 56. **These topics are too substantive to be addressed in the current study. They should be noted for possible future study.**

Reference to Corporations Code Section 7211

Proposed Section 4920(b) would be a new provision, stating:

> If the association is organized as a nonprofit mutual benefit corporation, notice of a board meeting is also governed by Section 7211 of the Corporations Code.

Ms. Artus believes that the cross-reference to Corporations Code Section 7211, in that provision, is too broad. She recommends that it be narrowed to refer only to Corporations Code Section 7211(a), which is the portion of the section relevant to meeting notice.

In fact, the reference could be narrowed further. It is only Section 7211(a)(2) that directly relates to meeting notice procedures. It provides:

> Regular meetings of the board may be held without notice if the time and place of the meetings are fixed by the bylaws or the board. Special meetings of the board shall be held upon four days' notice by first-class mail or 48 hours' notice delivered personally or by telephone, including a voice messaging system or by electronic transmission by the corporation (Section 20). The articles or bylaws may not dispense with notice of a special meeting. A notice, or waiver of notice, need not specify the purpose of any regular or special meeting of the board.

As can be seen, that paragraph largely duplicates the requirements of the Davis-Stirling Act (which would be continued in proposed Section 4920(a)), except to the extent that it is incompatible with those requirements (e.g., notice need not indicate the purpose of the meeting).

Consequently, any cross-reference to Section 7211 might do more harm than good. Without subdivision (b), there is a reasonable argument that the Davis-Stirling Act supersedes Section 7211(a)(2) to the extent of any inconsistencies. With subdivision (b), the application of Section 7211(a)(2) would seem to be reaffirmed.

For that reason, the staff recommends that subdivision (b) of proposed Section 4920 be entirely deleted.

Stylistic Suggestions

The RPLS Working Group suggests replacing "meeting" with the defined term "board meeting" in the first clause of subdivision (a). See Memorandum 2010-36, Exhibit p. 148. The proposed change would further the uniformity of language within the Davis-Stirling Act. **The staff recommends that it be made.**

The RPLS Working Group also suggests revising a number of provisions to make them plural (e.g., in subdivision (b), "notice of a board meeting" would be revised to read "notice of board meetings"). As a matter of drafting style, the Commission generally prefers the use of the singular, except where its use would be confusing or awkward. In this instance, the staff does not believe that changing to plural would be any clearer. **The staff does not see a compelling reason to make the change.**

Emergency Meeting

Under proposed Section 4920, the meeting notice requirements do not apply to an emergency meeting.

Proposed Section 4923 would continue the existing provision that authorizes an emergency meeting, thus:

> 4923. An emergency board meeting may be called by the president of the association, or by any two directors other than the president, if there are circumstances that could not have been reasonably foreseen which require immediate attention and possible action by the board, and which of necessity make it impracticable to provide notice as required by Section 4920.

Ms. Artus believes that the standard provided in that section needs "tightening." She proposes that the provision be revised to use the definition of "emergency" in proposed Section 4360(d), which authorizes emergency rulemaking in the event of "an imminent threat to public health or safety or imminent risk of substantial economic loss to the association." **This would be**

too substantive a change to make without more analysis and public input than is practical in the context of the current study. The issue should be noted for possible future study.

Open Meetings

Proposed Section 4925 would continue an existing open meeting provision:

> 4925. (a) Any member may attend board meetings, except when the board adjourns to executive session.
>
> (b) The board shall permit any member to speak at any meeting of the association or the board, except for meetings of the board held in executive session. A reasonable time limit for all members of the association to speak to the board or before a meeting of the association shall be established by the board.

The Commission received a number of comments on this provision. They are discussed below.

Mandatory Time Limits

The RPLS Working Group notes that proposed Section 4925(b) appears to mandate that a board adopt time limits for member testimony (i.e., time limits *shall* be established by the board). They recommend that the provision be revised to be permissive (i.e., the board *may* establish time limits). See Memorandum 2010-36, Exhibit p. 148.

This would be a minor substantive change, and probably a controversial one. There are places in the Davis-Stirling Act where the Legislature has mandated that an association think about a particular issue and adopt an express rule on the matter. See, e.g., proposed Section 5105 (election rules). The point is not to mandate any particular result, but to ensure that there be an express policy in place.

Proposed Section 4925(b) appears to be such a provision. Absent the provision's requirement, some associations might act in an ad hoc and inconsistent fashion, inviting disputes about fairness and preferential treatment. A requirement that all associations adopt some sort of express policy on member participation in board meetings seems aimed at reducing the scope for such problems. **The staff recommends against making any change to the provision.**

Scope of Member Participation

Kazuko Artus suggests revising proposed Section 4925 to bolster the right of members to participate in board meetings. Specifically, she would like to see

language requiring a board to solicit member comments and questions before *each* decision point. Further, she would like it made clear that the board may not restrict member speech beyond setting a "reasonable time limit for all members to speak." See Memorandum 2010-36, Exhibit p. 57. Presumably, the latter concern is that a board not be permitted to limit *when* members may speak (e.g., by limiting member participation to a comment period at the beginning of a meeting).

These proposals are too substantive to be addressed in the context of the current proposal. They should be noted for possible later study.

Association Meeting Provision

The RPLS Working Group notes that proposed Section 4925(b) refers to both a board meeting and a "meeting of the association." This strongly suggests that the provision is intended to apply to member meetings and meetings of association entities other than the board. To the extent that it applies to a member meeting, the RPLS Working Group suggests copying its substance into the provisions on member meetings. See Memorandum 2010-36, Exhibit p. 60. Kazuko Artus makes a similar suggestion. See Memorandum 2010-36, Exhibit p. 57.

This could be accomplished by revising proposed Section 5000 as follows:

> 5000. (a) Meetings of the membership of the association shall be conducted in accordance with a recognized system of parliamentary procedure or any parliamentary procedures the association may adopt.
>
> (b) Notwithstanding any other provision of law, notice of meetings of the members shall specify those matters the board intends to present for action by the members, but, except as otherwise provided by law, any proper matter may be presented at the meeting for action.
>
> (c) The board shall permit any member to speak at any meeting of the membership of the association. A reasonable time limit for all members to speak at a meeting of the association shall be established by the board.
>
> (d) If an association is organized as a nonprofit mutual benefit corporation, a member meeting is also governed by Sections 7510 through 7527 of the Corporations Code, inclusive.

Comment. …

Subdivision (c) continues the substance of former Section 1363.05(h), as that provision applied to a member meeting, except that the authority of the board to adopt time limits for members to speak is discretionary rather than mandatory.

…

The staff recommends that this revision be made. The revision would not establish any new substantive rights. It would simply highlight an existing right, by noting it in a location more relevant to its subject matter. It seems likely that this would be uncontroversial and beneficial.

Drafting Suggestion

Kazuko Artus believes that the substance of Section 4925 would be better expressed if subdivisions (a) and (b) were combined. While the proposed revision might make the provision clearer for some readers, the conservative drafting approach used in this study weighs against making the suggested change. **The staff recommends against doing so.**

Adjournment to Executive Session

The RPLS Working Group suggests that proposed Section 4925 be revised to indicate that a board may meet in executive session without first meeting in open session. See Memorandum 2010-36, Exhibit p. 149. That issue will be discussed in connection with the provision governing executive session, below.

Executive Session

Proposed Section 4935 would continue the existing provisions on the use of closed executive sessions by the board of directors, thus:

4935. (a) The board may adjourn to executive session to consider litigation, matters relating to the formation of contracts with third parties, member discipline, personnel matters, or to meet with a member, upon the member's request, regarding the member's payment of assessments, as specified in Section 5665.

(b) The board shall meet in executive session, if requested by a member who may be subject to a fine, penalty, or other form of discipline, and the member shall be entitled to attend the executive session.

(c) The board shall meet in executive session to discuss a payment plan pursuant to Section 5665.

(d) The board shall meet in executive session to decide whether to foreclose on a lien pursuant to subdivision (b) of Section 5705.

(e) Any matter discussed in executive session shall be generally noted in the minutes of the immediately following meeting that is open to the entire membership.

Topics Authorized for Consideration in Executive Session

Kazuko Artus suggests that proposed Section 4935 be revised to add two additional topics to the list of topics authorized for consideration in executive session: (1) attorney advice that should be kept confidential, and (2) mediation and arbitration. On the latter point, she notes that mediation and arbitration often serve as an alternative or prelude to litigation and so should be treated in the same way as litigation. See Memorandum 2010-36, Exhibit p. 58.

The staff believes that any expansion of the scope of executive session would be too substantive and controversial for inclusion in the proposed law. In our experience, the scope of the open meeting requirement is one of the more controversial aspects of the Davis-Stirling Act. **The suggestions should be noted for possible future study.**

Executive Session Disclosures and Challenge

Kazuko Artus suggests that the agenda for a board meeting should list any matters to be discussed in executive session. Further, she thinks the law should require that the board announce the topic of an executive session before commencing it, along with a statement of the authority for considering the topic in executive session. Finally, she believes members should have an immediate opportunity to contest the propriety of the proposed executive session. See Memorandum 2010-36, Exhibit p. 58.

These proposals would require more study and public input than is practical in the context of the current study. They should be noted for possible future study.

"Adjournment" to Executive Session

Both proposed Section 4925 and proposed Section 4935 would continue existing language on when a board may or must "*adjourn* to executive session." (Emphasis added.) The reference to "adjournment" implies that a board must first meet in open session, before commencing an executive session. The RPLS Working Group suggests that this requirement is impractical, as there are times when the sole purpose for meeting is to consider executive session matters (e.g., to meet with counsel to discuss pending litigation). The group recommends that

the statute be revised to delete the adjournment language. See Memorandum 2010-36, Exhibit p. 150.

The Commission had included this change in its prior version of the proposed law (introduced in 2008 as AB 1921 (Saldaña)). However, that change drew opposition and was amended out of the bill as too controversial. **Given that experience, the staff recommends against reintroducing this controversial change in the current proposal. It should be noted for possible future study.**

Drafting Suggestions

Duncan McPherson suggests revising proposed Section 4935(b) to improve its clarity. See Memorandum 2010-36, Exhibit p. 68. The provision reads as follows:

> (b) The board shall meet in executive session, if requested by a member who may be subject to a fine, penalty, or other form of discipline, and the member shall be entitled to attend the executive session.

That language is oddly constructed, with no direct statement of the subject of the executive session. Read literally, it authorizes any member who may be subject to discipline to call an executive session and attend. **Because of the potential for misunderstanding that important provision, the staff recommends that it be recast for clarity, thus:**

> (b) The board shall meet in executive session to discuss member discipline, if requested by the member who is the subject of the discussion. That member shall be entitled to attend the executive session.

The RPLS Working Group suggests that subdivision (d) be revised to read "to foreclose a lien," rather than "to foreclose on a lien." See Memorandum 2010-36, Exhibit p. 150. **Given the conservative drafting approach taken in this study, the staff recommends against making the change. The issue should be noted for consideration when the Commission conducts a separate study of the finance and accounting provisions of the Davis-Stirling Act.**

Minutes

Proposed Section 4950(a) would continue the existing rules on the preparation and distribution of board meeting minutes, thus:

> The minutes, minutes proposed for adoption that are marked to indicate draft status, or a summary of the minutes, of any board meeting, other than an executive session, shall be available to

> members within 30 days of the meeting. The minutes, proposed minutes, or summary minutes shall be distributed to any member upon request and upon reimbursement of the association's costs for making that distribution.

Alec Pauluck suggests three substantive changes to this provision: (1) Minutes should be *mailed* to all members, not just available to them, (2) the time for distribution of minutes should be shortened from 30 days after a meeting, to 15 days after a meeting, and (3) the rules governing minutes should apply to all association meetings, not just board meetings. See Memorandum 2010-36, Exhibit p. 47.

These substantive proposals require more analysis and public input than is practical in the context of the current study. They should be noted for possible future study.

Board Meeting Quorum

In Memorandum 2010-47, the staff deferred discussion of whether the law should require that the quorum for a board meeting be at least a simple majority of the board members. See Memorandum 2010-47, p. 5. The issue had been raised by the RPLS Working Group, which feels strongly that permitting a quorum of less than a majority is bad policy. See Memorandum 2010-36, Exhibit pp. 113-14.

As noted, existing law does not require that the quorum be a majority or more. To the contrary, the Corporations Code expressly permits a quorum as small as one-fifth of the number of directors, or two directors, whichever is larger. See Corp. Code § 7211(a)(7).

Consequently, any adjustment to the minimum quorum required by statute would be a significant substantive change in the law. **The staff believes that such an important change in governance policy should not be made without thorough public review and comment, beyond what is practical in the context of the current study. The issue should be noted for possible future study.**

MEMBER MEETINGS

Proposed Section 5000 governs the conduct of member meetings, thus:

> 5000. (a) Meetings of the membership of the association shall be conducted in accordance with a recognized system of parliamentary procedure or any parliamentary procedures the association may adopt.

(b) Notwithstanding any other provision of law, notice of meetings of the members shall specify those matters the board intends to present for action by the members, but, except as otherwise provided by law, any proper matter may be presented at the meeting for action.

(c) If an association is organized as a nonprofit mutual benefit corporation, a member meeting is also governed by Sections 7510 through 7527 of the Corporations Code, inclusive.

Subdivisions (a) and (b) of that section would continue existing law. Subdivision (c) would be new.

Relationship to Corporations Code

The California Association of Community Managers ("CACM") object to proposed subdivision (c), on the grounds that some provisions of Corporations Code Section 7513 conflict with the election provisions of the Davis-Stirling Act. See Memorandum 2010-36, Exhibit p. 211. They believe this could be problematic and suggest that the subdivision either be deleted or revised to address the inconsistency.

The staff recommends that the provision be deleted (thereby preserving existing law, which does not include the provision). Although the reference to the Corporations Code could be helpful in pointing out the many meeting provisions of the Corporations Code that are compatible with the Davis-Stirling Act, the absoluteness of the language might be misleading where the two bodies of law are in conflict.

MEMBER ELECTIONS

The Davis-Stirling Act provides fairly extensive rules for conducting member elections. See Sections 1363.03, 1363.04, 1363.09. Those provisions are continued in the proposed law as proposed Sections 5100-5145.

The existing election provisions have been fairly controversial and were the product of extended legislative negotiations and compromise. The staff believes that any substantive change to those provisions would be too controversial for inclusion in the proposed law. **For that reason, the staff generally recommends against any significant substantive change to the election provisions in this study.**

Comments on the election provisions are discussed below.

Application of Election Provisions

Proposed Section 5100 would state the application of the member election provisions, thus:

> 5100. (a) Notwithstanding any other law or provision of the governing documents, elections regarding assessments legally requiring a vote, election and removal of directors, amendments to the governing documents, or the grant of exclusive use of common area property pursuant to Section 4600 shall be held by secret ballot in accordance with the procedures set forth in this article.
>
> (b) This article also governs an election on any topic that is expressly identified in the operating rules as being governed by this article.
>
> (c) The provisions of this article apply to both incorporated and unincorporated associations, notwithstanding any contrary provision of the governing documents.
>
> (d) The procedures set forth in this article shall apply to votes cast directly by the membership, but do not apply to votes cast by delegates or other elected representatives.
>
> (e) In the event of a conflict between this article and the provisions of the Nonprofit Mutual Benefit Corporation Law (Part 3 (commencing with Section 7110) of Division 2 of Title 1 of the Corporations Code) relating to elections, the provisions of this article shall prevail.

The RPLS Working Group suggests two revisions to improve subdivision (a). First, they note that the reference to an assessment increase "legally requiring a vote" might be misunderstood, since all assessment increases require a vote of the board of directors. See Memorandum 2010-36, Exhibit p. 151. They suggest revising the language to emphasize that it is only referring to an assessment increase that requires approval of the *members*, thus:

> …elections regarding assessments legally requiring approval by a majority of a quorum of the members (Section 5605)…

The staff is not sure that this change is necessary, because subdivision (d) expressly limits the election procedures to votes of the members (expressly excluding votes of elected representatives, like directors). **Given the generally conservative drafting approach being taken in this study, and the heightened sensitivity surrounding the election provisions, the staff recommends against making the proposed revision.**

The RPLS Working Group also suggests deleting the word "property" from the phrase "common area property." *Id*. This would be a nonsubstantive change that would further our goal of using standardized terminology and defined

terms where possible. The change should be entirely uncontroversial. **The staff recommends that it be made.**

As a general point, the RPLS Working Group recommends that the Commission revive its earlier inquiry into whether small associations should have the option of using more streamlined election procedures. *Id.* **This would be too controversial a topic to address in the current study.**

Election Rules

Proposed Section 5105 would continue existing law requiring that an association adopt "election rules" on specified topics. The Commission received a number of comments on this provision, which are discussed below.

Default Rules

Duncan McPherson suggests that it would be better for the law to provide a set of default rules on the specified topics, which would apply if an association does not adopt its own rules. This would avoid the problems that might arise if an association fails to adopt the required rules. See Memorandum 2010-36, Exhibit p. 68. The Commission previously explored a similar approach, but it proved controversial. **The issue should not be addressed in this study.**

Self-Nomination

Duncan McPherson notes that the provision requiring that the election rules permit self-nomination may be at odds with other existing provisions of an association's governing documents. In such a case, the election rules should not be required to be consistent with the inconsistent rules in other governing documents. See Memorandum 2010-36, Exhibit p. 68.

Issues of this type were discussed generally in Memorandum 2010-48 and its First Supplement. The Commission's resolution of the matter is described on page 6 of the Minutes of the October 14, 2010, meeting. **Because the Commission has extensively considered this point, the staff is not inclined to reopen the matter.**

On a related point, Mr. McPherson suggests that the law should allow for election rules to prohibit nomination of candidates from the floor of an annual meeting. Nominations from the floor would often be incompatible with conducting an election by mail, which is otherwise authorized under the election provisions of the Davis-Stirling Act. See Memorandum 2010-36, Exhibit p. 68. Although there is undoubtedly room for improvement of the election

procedures, **the staff believes that changes of this type are too substantive and potentially controversial to be addressed in the proposed law. The issue should be noted for possible future study.**

Election Inspector

Proposed Section 5110 would continue, without substantive change, the existing provisions governing the qualifications and selection of an independent election inspector. The Commission received two comments on the provision.

First, Duncan McPherson comments on a provision of subdivision (b) that precludes the selection of any of the following persons to serve as an election inspector:

> a person, business entity, or subdivision of a business entity who is currently employed or under contract to the association for any compensable services unless expressly authorized by rules of the association adopted pursuant to paragraph (5) of subdivision (a) of Section 5105.

Mr. McPherson suggests that the reference to a "business entity" is misplaced, since only a natural person could serve as an election inspector. He believes that the provision should probably refer to an employee or agent of a business entity. See Memorandum 2010-36, Exhibit p. 69.

The staff recommends against making the proposed revision. While it is true that the duties of an election inspector must be performed by an individual, the restriction stated in the passage quoted above should apply to the business entity that provides the inspectors, not to the inspectors themselves. For example, suppose that an association contracts with a large property management company to provide election inspection services. The restriction stated in proposed Section 5110(b) should turn on the relationship between the association and the property management company. The question of whether the association has a contractual relationship with the individual persons chosen by the property management company to perform inspection duties should not be the issue. Otherwise, the association and property management company could circumvent the statutory restriction, simply by ensuring that the individuals chosen to perform the inspection duties are not in direct privity with the association.

Second, the RPLS Working Group suggests that the section heading be revised to better conform to the terminology used in the section and in the Corporations Code:

§ 5110 (REVISED). ~~Election inspector~~ Inspector of election

As the staff has noted before, section headings are not part of the law and have no legal effect. **Nonetheless, the staff agrees that the change would be an improvement in the Commission's report and recommends that it be made.**

Voting Procedure

Proposed Section 5115 would continue the provisions that set out the procedure to be followed in conducting a member election. The Commission received a number of comments on this provision.

Duncan McPherson has suggested the following changes to the provision:

- The law should not require an election to be held if the number of fairly nominated candidates is equal to or less than the number of positions being filled. See Memorandum 2010-36, Exhibit p. 69.
- The law should be clearer in stating the prerequisites for use of "cumulative voting" in an association election. *Id*.
- The quorum requirement for a director election should perhaps be reduced or eliminated. *Id*.

These suggestions are also endorsed by the Community Associations Institute - California Legislative Action Committee ("CAI-CLAC"). See Memorandum 2010-36, Exhibit p. 198. **The staff considers these issues to be too controversial for inclusion in the proposed law, or to require more study and public input than is possible in the current study.**

Two other comments on the election procedure provision are discussed below.

☞ **Signed Envelope**

The existing election procedure uses a double-envelope procedure to ensure the confidentiality of ballots cast by mail. A member marks a ballot to indicate the vote cast but does not include any personal information to indicate the identity of the member who cast the ballot. The ballot is then placed into an unmarked envelope. That "inside" envelope is then placed into an "outside" envelope that includes the name and address of the member casting the vote. On receipt, the member's identity and voting eligibility can be determined from the

outside envelope. The inside envelope can then be set aside for counting, without anything to identify the member who cast the ballot.

Duncan McPherson writes to express concern about one aspect of the procedure. A member must "sign" the outside envelope. See proposed Section 5115(a)(1). Mr. McPherson indicates that many people are uneasy about mailing an envelope that bears their name, address, and signature on the outside. Reportedly, some members have been so worried about the privacy issues associated with the signature requirement that they have chosen to not participate in elections. See Memorandum 2010-36, Exhibit p. 69.

There does seem to be significant anxiety about the identity theft risk that might result from being required to sign the outside of the envelope. The staff has heard a number of complaints about the requirement.

The question is whether that change could be made without adding cost or complexity to a procedure that is already somewhat costly and complicated.

The simplest solution might be the one suggested by Mr. McPherson, simply eliminate the signature requirement. The law could still require that the member's name and address be *printed* on the outside of the envelope, but without a signature. That might provide enough information to validate the member's identity and voting rights when processing the ballot. The change would not result in any new costs and would actually simplify the process somewhat.

However, some associations might want to be able to check signatures, to ensure that votes are not being cast fraudulently. To the extent this is true, an alternative might be to require that a signature form be signed and included in the envelope. However, this would add to the cost and complexity of the procedure, and might increase the risk of error.

The signature requirement is clearly causing concern. However, it is not clear that the issue can be addressed in the current study. **It should be discussed by the Commission.**

On a related point, Sun City Roseville suggests allowing the signature to be on the back of the envelope. See Exhibit p. 3. That would not eliminate the identity theft risk discussed above, but might be easier as a practical matter (there is more room on the back to sign than on the front). **If the Commission decides to retain the signature requirement, it is worth considering whether to allow the option of signing on the back.**

Counting Ballots

Proposed Section 5120 would continue existing provisions on ballot tabulation. Subdivision (b) of that section requires that notice of the results of an election be distributed within 15 days of the election. CACM suggests lengthening that period to 30 days, to fit more efficiently within the cycle of regular monthly mailings.

The staff believes that the proposed change would be too controversial for inclusion in the proposed law.

☞ **Ballot Custody**

Proposed Section 5125 would continue the existing rules governing retention of ballots, with one significant substantive change. Under existing law, the ballots must be retained until expiration of the time for challenging an election under Corporations Code Section 7527 (i.e., nine months after the election). Proposed Section 5125 would instead require that the records be retained until expiration of the time for challenging an election under proposed Section 5145 (i.e., one year after the election). *Note that this would not affect the time available to challenge an election.* It would simply require that ballots be retained during the period in which an election may be challenged under existing law. It would be problematic to permit the destruction of ballots while a judicial challenge is still possible.

Both CACM and the RPLS Working Group object to the proposed change. However, it is not clear from their comments that they are recognizing the distinction between the time during which ballots must be retained and the time during which an election challenge may be commenced. This section addresses only the first issue. Nothing in this section (or elsewhere in the proposed law) would change existing law on the second point. See Section 1363.09(a) (election challenge may be filed within one year).

For example, CACM writes to explain why a nine-month challenge period is superior to a one-year challenge period:

> There is a reason for a 9 month period, and it has everything to do with noticing and holding the next year's annual election. By the time the owner challenges the old election one year out, a new one has already been noticed and likely held. By keeping the period at 9 months, the Corporations Code allows the courts to dictate who is on the board and the number of seats remaining prior to the next election, rather than potentially upsetting two elections, and *de facto*

> requiring a third annual election to fix the fallout. We recommend leaving the time to challenge an election at nine (9) months.

See Memorandum 2010-36, Exhibit p. 211.

Similarly, the RPLS Working Group writes:

> The reason why the Corporations Code provision (which has been part of that law since 1978) puts an outside limit of nine months on election challenges is so that most challenges can be asserted and resolved *before the next annual election cycle begins.* Under the Corporations Code rule there is a greater likelihood that at the time of an annual election the association and its members will know how many seats must be filled and the election at hand will not be marred by continuing conflicts over the outcome of past elections.

See Memorandum 2010-36, Exhibit p. 152.

These are good arguments, but they are arguments for making a substantive change to proposed Section 5145, to shorten the existing time for a challenge from twelve months to nine. **The staff feels strongly that such a substantive diminution of member rights would be too controversial to be included in the proposed law.**

If the Commission agrees, it must decide whether to revise proposed Section 5125 to restore the existing rule on retention of ballots (i.e., nine month retention required), even though that rule would seem to permit the destruction of ballots three months before expiration of the one year period for challenging an election under existing Section 1363.09. **The more conservative approach would be to restore the existing rule and note the issue for possible future study, but it is worth discussing.** It seems likely that the inconsistency between the ballot retention period and the election challenge period was inadvertent and could lead to significant problems.

Proxies

Proposed Section 5130 would continue existing Davis-Stirling Act provisions governing the use of proxies in a CID election, without substantive change. The Commission received a number of comments on the proxy provisions.

Limit Proxy Use

Duncan McPherson suggests that proxies should not be permitted in director elections. He believes that the procedural difficulties inherent in implementing

proxies under the current balloting system would lead to unnecessary fraud and disputes. See Memorandum 2010-36, Exhibit p. 70.

Similarly, the RPLS Working Group suggests that proxies be prohibited when mailed ballots are used to conduct an election. See Memorandum 2010-36, Exhibit p. 153.

The Commission has previously acknowledged the procedural problems that will inevitably arise if proxies are permitted under the double-envelope ballot system. There is no good way to validate that a ballot contained within the secret inside envelope has been cast pursuant to instructions provided in a proxy. If we were writing on a blank slate, the staff would recommend that proxies be prohibited or that the double-envelope system be restructured somehow to permit the validation of proxies. Unfortunately, such changes would be too controversial for inclusion in the proposed law and would require more study and public input than is practical in the context of the proposed law. **The issue should be noted for possible future study.**

Definition of "Signed"

The proposed law would continue an existing definition of "signed" that is used in the proxy provision, thus:

> "Signed" means the placing of the member's name on the proxy (whether by manual signature, typewriting, telegraphic transmission, or otherwise) by the member or authorized representative of the member.

The RPLS Working Group has two concerns about that definition.

First, the group notes that the definition of "signed" differs substantively from the definition used in the Corporations Code. Specifically, proposed Section 5130 would permit a proxy to be signed by a member or by an "authorized representative of the member." That language is broader than Corporations Code Section 5069, which only recognizes a proxy signed by the member or the member's "attorney-in-fact." See Memorandum 2010-36, Exhibit p. 152.

While the staff recognizes the benefit of using standardized terminology in the Davis-Stirling Act and the Corporations Code, that is a principle that has often been set aside, when the Legislature decides to tailor the law for the special needs of CIDs. It is unclear whether this is such a case (i.e., whether the Legislature intended to recognize a broader class of agents than just attorneys-in-fact), or is merely an inadvertent drafting deviation.

The staff believes that the issue requires more analysis and public input than is practical in the context of the current study and recommends retaining the existing language in the proposed law. The issue should be noted for possible future study.

In addition, the RPLS Working Group suggests modernizing the reference to "telegraphic" transmission (which is in both the Davis-Stirling Act and the Corporations Code) to refer instead to electronic communication. The staff is reluctant to do so, for three reasons:

(1) The list of authorized signature methods in proposed Section 5030 is non-exclusive. It concludes with an open-ended catch-all. Consequently, there does not seem to be any legal problem that needs to be resolved in order for the section to operate as intended.
(2) The technicalities surrounding assent to send and receive electronic communications in official communications of this type are significant. The staff is concerned that adding the term "electronic communications" to the list might have some unintended effect.
(3) If proposed Section 5030 were revised, it would either introduce a new inconsistency between the Davis-Stirling Act and the Corporations Code, or require a parallel change in the Corporations Code. Any change to the Corporations Code would be beyond the scope of the current study.

The staff recommends that the issue be noted for possible future study.

Voting Rights and Joint Ownership

Proposed Section 5140 would provide default rules on member voting rights, thus:

> 5140. Unless the governing documents provide otherwise:
> (a) A member who is entitled to vote may cast one vote for each separate interest that the member owns.
> (b) If a separate interest is owned by more than one person, each owner shall be a member of the association, but their joint ownership has no effect on the number of votes cast for that separate interest.

The provision has no antecedent in the Davis-Stirling Act. It is drawn from a Department of Real Estate regulation. See 10 Cal. Code Regs. § 2792.18(a).

Distribution of Materials to Joint Owners

Alec Pauluck suggests that ballot materials should be delivered to every owner named in the county property records. See Memorandum 2010-36, Exhibit

p. 48. **The staff believes this would be too burdensome a requirement to impose on associations.** It would require the association to search the title records of each separate interest before every election. The existing system places the burden on members to keep the association apprised of where to send ballot materials. This is more workable, as it only requires action when the ownership of a separate interest changes. The affected owners are in the best position to know and report such changes.

Corporations Code Sections 7312 and 7612

Both the RPLS Working Group and CACM suggest it would be better to adopt the joint voting right rules stated in Corporations Code Sections 7312 and 7612. See Memorandum 2010-36, Exhibit pp. 153, 212.

In relevant part, Sections 7312 and 7612 provide as follows:

> 7312. No person may hold more than one membership, and no fractional memberships may be held, except as follows:
>
> (a) Two or more persons may have an indivisible interest in a single membership when authorized by, and in a manner or under the circumstances prescribed by, the articles or bylaws subject to Section 7612.
>
> (b) If the articles or bylaws provide for classes of membership and if the articles or bylaws permit a person to be a member of more than one class, a person may hold a membership in one or more classes.
>
> (c) Any branch, division, or office of any person, which is not formed primarily to be a member, may hold a separate membership.
>
> (d) In the case of membership in an owners' association, created in connection with any of the forms of development referred to in Section 11004.5 of the Business and Professions Code, the articles or bylaws may permit a person who owns an interest, or who has a right of exclusive occupancy, in more than one lot, parcel, area, apartment, or unit to hold a separate membership in the owners' association for each lot, parcel, area, apartment, or unit.
>
> (e) In the case of membership in a mutual water company, as defined in Section 14300, the articles or bylaws may permit a person entitled to membership by reason of the ownership, lease, or right of occupancy of more than one lot, parcel, or other service unit to hold a separate membership in the mutual water company for each lot, parcel, or other service unit.
>
> (f) In the case of membership in a mobilehome park acquisition corporation, as described in Section 11010.8 of the Business and Professions Code, a bona fide secured party who has, pursuant to a security interest in a membership, taken title to the membership by way of foreclosure, repossession, or voluntary repossession, and

who is actively attempting to resell the membership to a prospective homeowner or resident of the mobilehome park, may own more than one membership.

7612. If a membership stands of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, persons entitled to vote under a voting agreement or otherwise, or if two or more persons (including proxyholders) have the same fiduciary relationship respecting the same membership, unless the secretary of the corporation is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting shall have the following effect:

(a) If only one votes, such act binds all; or

(b) If more than one vote, the act of the majority so voting binds all.

The advantage of the approach proposed by the RPLS Working Group and CACM is that the Corporations Code provisions are more detailed and complete than proposed Section 5140.

The disadvantage is that the Corporations Code provisions are harder for a layperson to read and understand. For example, Section 7312 begins by stating generally that a person may only hold one membership. This is at odds with the common practice in many CIDs, in which a person may hold multiple memberships, one for each separate interest owned. To find the language permitting that practice, one must read and understand the exception stated in Section 7312(d), which does not specifically mention CIDs. Instead it refers to "any of the forms of development referred to in Section 11004.5 of the Business and Professions Code." Consequently, in order to learn the rule stated fairly simply and directly in proposed Section 5140(a), a reader would need to follow a cross-reference to the Corporations Code, recognize that Section 7312(d) might state a relevant exception, and then follow the cross-reference to the Business and Professions Code.

The staff recommends against that approach. Instead, the staff recommends deleting proposed Section 5140. That would avoid any risk that the simplified rules stated in that provision might result in an unintended and problematic change in the law. The Department of Real Estate requires that a CID's governing documents address voting rights in a fair and reasonable way. Those governing documents are undoubtedly drafted to be compatible with governing law.

Consequently, it might be best to leave the matter to the governing documents. They should directly state the rules that govern a particular CID, without any need for a statutory gloss of the type that proposed Section 5140 would provide.

If the Commission decides against deleting proposed Section 5140, it should consider a suggestion from Sun City Roseville, that the provision be moved to a more prominent location. See Exhibit p. 3.

"Voting Power" and "Quorum"

An earlier memorandum noted a suggestion that the proposed law define the terms "voting power" and "quorum" to make clear that they only encompass members who are in good standing and therefore entitled to vote. The staff wrote:

> CACM recommends adding language to proposed Sections 4065 and 4070 to make clear that the required approval threshold should be calculated by including only those members who are in good standing and are therefore entitled to vote. See Memorandum 2010-36, Exhibit pp. 206-07.
>
> That is a valid point that could be addressed through careful definition of the terms "quorum" and "voting power." **Those definitions would need to be addressed in a future memorandum.** (Note that the RPLS Working Group is independently urging the Commission to develop a definition of "voting power," consistent with Corporations Code Section 5078. See Memorandum 2010-36, Exhibit p. 112. That issue will be addressed in a future memorandum.)
>
> Note that the revisions proposed above, to more closely track language from the Corporations Code, goes some distance toward addressing the issue. As revised, proposed Section 4065 would refer to "votes entitled to be cast." That revision should be sufficient to address part of CACM's concern.

See First Supplement to Memorandum 2010-29, p. 17 (emphasis in original). As indicated in the last paragraph of that passage, proposed Section 4065 was revised to more closely follow parallel language in the Corporations Code, which refers to "votes entitled to be cast," thus:

> 4065. If a provision of this Act requires that an action be approved by a majority of all members, the action shall be approved or ratified by an affirmative vote of a majority of the votes entitled to be cast.

See Minutes (Aug. 2010), p. 9.

The staff now returns to the question of whether the proposed law should use the term "voting power."

Definition of "Voting Power"

There is only one section of the existing Davis-Stirling Act that uses the term "voting power." Section 1363.03(a)(4) requires that an association's election rules specify:

> the qualifications for voting, the *voting power* of each membership, the authenticity, validity, and effect of proxies, and the voting period for elections, including the times at which polls will open and close, consistent with the governing documents.

(Emphasis added). Subparagraph (c)(3)(A) of the same section requires that an election inspector determine:

> the number of memberships entitled to vote and the *voting power* of each.

(Emphasis added.) The term "voting power" is not defined in the Davis-Stirling Act.

Although it has no direct application to the Davis-Stirling Act, the Nonprofit Corporation Law does include a definition of "voting power":

> 5078. "Voting power" means the power to vote for the election of directors at the time any determination of voting power is made and does not include the right to vote upon the happening of some condition or event which has not yet occurred. In any case where different classes of memberships are entitled to vote as separate classes for different members of the board, the determination of percentage of voting power shall be made on the basis of the percentage of the total number of authorized directors which the memberships in question (whether of one or more classes) have the power to elect in an election at which all memberships then entitled to vote for the election of any directors are voted.

Corp. Code § 5078.

It would be possible to incorporate that definition in the Davis-Stirling Act, but **the staff recommends against doing so in this study.** Corporations Code Section 5078 focuses on eligibility to vote in a *director* election. The staff is not certain that this standard would be appropriate in all cases in a CID. For example, it is possible that a CID's governing documents might use different standards for eligibility to vote in a director election versus an election to amend the declaration. If so, adoption of the Corporations Code definition would trump

those governing documents, substantively altering member voting rights in unanticipated ways. **The issue requires more analysis and public input than is practical in the context of the current study. It should be noted for possible future study.**

Another possibility would be to create a new definition for use in the Davis-Stirling Act, consistent with the usage in Section 1363.03. In that context, "voting power" seems to mean "eligibility to vote." **Again, the staff recommends against doing so in this study.** The language in the existing provision seems sufficiently understandable without adding a definition of "voting power." Any attempt to define the term might inadvertently change its intended or understood meaning. It would be best to leave it alone for now.

In fact, the staff recommends deleting the term "voting power" from two provisions of the proposed law where the term had been added by the Commission. Those additions had been intended to promote the use of standardized language. Given the Commission's decision to delete the term "voting power" from proposed Section 4065, there is less to be gained by adding the term elsewhere.

Specifically, the staff recommends the following revisions, which would delete the term "voting power" and more closely track the language of existing law:

> **§ 4230 (REVISED). Deletion of declarant provisions in governing documents**
>
> 4230.…
>
> …
>
> (d) The board may not amend the governing documents pursuant to this section without the approval of a majority of a quorum of the members, pursuant to Section 4070. For the purposes of this section, "quorum" means ~~members representing~~ more than 50 percent of the ~~voting power of the association, excluding~~ members who own no more than two separate interests in the development.

> **§ 5605 (REVISED). Assessment approval requirements**
>
> 5605.…
>
> …
>
> (c) For the purposes of this section, "quorum" means ~~members representing~~ more than 50 percent of the ~~voting power of the association~~ members.

The proposed changes would be consistent with a suggestion made by Sun City Roseville. See Exhibit p. 3.

On a related point, Sun City Roseville questions why proposed Section 4230(d) provides that an owner of more than two units "can vote two separate interests, but not more." *Id*.

The staff reads the provision differently. It doesn't seem to limit the number of votes that can be cast by a member. Instead, it provides that owners of more than two separate interest aren't counted in determining a quorum. T**he staff is not sure why that rule exists, and so is inclined against trying to clarify its meaning in the current proposal. The risk of inadvertent substantive change seems too high.**

Definition of "Quorum"

It has been suggested that the proposed law include a definition of "quorum" that would govern the meaning of the term in the member meeting and voting provisions of the Davis-Stirling Act. **The staff recommends against adding such a definition.**

It seems very likely that most CIDs already have an appropriate rule stating the quorum for a member meeting, as part of their governing documents. The Department of Real Estate's regulations require that the governing documents of new CIDs include "reasonable arrangements" on a number of governance matters, including a requirement that a quorum be stated for member meetings:

> [A] quorum for the transaction of business at a meeting of members of the Association through presence in person or by proxy shall be established at a percentage of not less than 25% and not more than 66 2/3% of the total voting power of the Association. Within these percentage limits, the quorum requirements for members' meetings shall be suited to such factors as the proposed physical layout of the subdivision, the contemplated number of owners of subdivision interests and the nature and extent of the common areas, facilities and services.

10 Cal. Code Regs. § 2792.17(e)(1). Notably, that standard recognizes that a one-size-fits-all rule would not be appropriate, given the scope for variation in CID size and character.

The staff believes that these considerations weigh against imposing a fixed statutory definition of "quorum." If association governing documents already address the issue, then there is no need for a statutory rule. If associations need

flexibility in setting their quorum, then any statutory mandate could be inappropriately constraining.

Judicial Enforcement

Proposed Section 5145 would continue, without substantive change, existing Section 1363.09, as that provision relates to judicial enforcement of the member election provisions.

As discussed earlier, under "Ballot Custody," CACM objects to the 12-month period provided for commencing an election challenge under this provision. CACM suggests that the Davis-Stirling Act be conformed to the nine-month period provided under the Corporations Code, which they see as more appropriate in associations that follow an annual election cycle. See Memorandum 2010-36, Exhibit p. 212.

Whatever the merits of that suggestion, **the staff believes that the proposed change would be too substantive and controversial for inclusion in the proposed law.** Further, the most recent and specific expression of legislative policy is to provide 12 months for an election challenge, notwithstanding CACM's arguments. **The issue should be noted for possible future study.**

CACM also suggests that proposed Section 5145(b) be revised to eliminate the existing asymmetry regarding the recovery of fees and costs in an election contest action. See Memorandum 2010-36, Exhibit p. 212.

Under existing law, a prevailing contestant is entitled to fees and costs. By contrast, a prevailing association will only receive fees and costs if the court finds that the contest was "frivolous, unreasonable, or without foundation." See Section 1363.09(b).

The substantive change proposed by CACM is too controversial for inclusion in the proposed law. It should be noted for possible future study.

RECORD INSPECTION

Existing law contains fairly detailed rules on member inspection of association records. See Section 1365.2. Those rules are continued in proposed Sections 5200-5240. The Commission received a number of comments on the record inspection provisions, as discussed below.

Definitions

Proposed Section 5200 would continue existing definitions of the terms "association records" and "enhanced association records." Those definitions establish the scope of the record inspection rights (which only apply to an "association record" or "enhanced association record"). Comments on the definitions are discussed below.

Location

The RPLS Working Group suggests relocating proposed Section 5200 to the beginning of the Act, with the other definitions that govern the Act as a whole. **The staff recommends against making the change.**

Section 5200 uses a fairly general term, "association records," in a specially limited way, to mean only those records that are subject to member inspection. That approach is fine if the definition only governs the member inspection provisions (as in the proposed law), but it could be problematic if given broader application.

For example, proposed Section 5250, which relates to record retention, uses the term "association records" in a more general sense. It is not intended that the term have the special meaning provided in Section 5200.

Association "Journal"

In an earlier memorandum, Kazuko Artus had suggested that the association's accounting "journal" be added to the list of "association records" in proposed Section 5200. See Memorandum 2009-44, pp. 24-25. In response, the Commission added a note following proposed Section 5200, specifically soliciting public comment on that issue.

Ms. Artus writes to renew her suggestion:

> A journal (the place where transactions are recorded as they occur, the book of original entry) should be included in the definition of "association records," in addition to a general ledger. As I said earlier, a journal and the corresponding ledger record exactly the same information in two different formats, but for some (perhaps many) readers it is easier to spot bookkeepers' errors by reviewing a journal than the accompanying ledger. It makes no sense to require associations to offer ledgers for members' inspection and not the accompanying journals.

See Memorandum 2010-36, Exhibit p. 58.

The RPLS Working Group recommends against making the change. They maintain that the meaning of "journal" is not sufficiently clear and that the addition of the term would create new uncertainty. See Memorandum 2010-36, Exhibit p. 155.

CACM makes a similar point. They see no significant benefit to adding the "journal" (noting that the general ledger is already listed as a type of "association record"). CACM is also concerned that the term is not well defined and could introduce uncertainty. See Memorandum 2010-36, Exhibit p. 212.

Given this mixed response, and the Commission's general decision to defer action on issues relating to the refinement of accounting terminology, **the staff recommends that the change not be made in the proposed law.**

☞ *Accrual or Modified Accrual Accounting*

Proposed Section 5200(a)(3)(D) would continue an existing provision that has drawn much criticism during the course of this study. It provides that "association records" include:

> (3) Interim financial statements, periodic or as compiled, containing any of the following:
> …
> (D) General ledger. A "general ledger" is a report that shows all transactions that occurred in an association account over a specified period of time.
> The records described in this paragraph shall be prepared in accordance with an accrual or modified accrual basis of accounting.

It is the second sentence of subparagraph (D) that has been criticized. That sentence goes beyond defining a type of record and instead mandates that a particular accounting method be used in preparing the described documents ("accrual or modified accrual" accounting). Criticisms of the provision include:

- The meaning of "modified accrual" accounting is not sufficiently clear. See Memorandum 2010-36, Exhibit p. 58, 70.
- It would be better to permit cash accounting. See Memorandum 2010-36, Exhibit pp. 58-59, 70
- The requirement is inconsistent with proposed Section 5300(b)(1), which requires that the budget be prepared on "an accrual basis." See Memorandum 2010-36, Exhibit pp. 70, 154.
- A substantive rule governing accounting methods should not be buried in the middle of a definition of records subject to inspection. See Memorandum 2010-36, Exhibit pp. 70, 154.

- The scope of the requirement is unclear. Does it only relate to the general ledger, or does it apply to all of the financial statements listed in paragraph (3)? See Memorandum 2010-36, Exhibit p. 154.

The staff recommends against making any substantive change to the criticized provision. Something as significant and potentially controversial as a change to the accounting method mandated by law, should not be undertaken without more analysis and public input than is possible in the context of the current study. **The Commission has previously indicated its interest in undertaking a comprehensive review of the accounting provisions of the Davis-Stirling Act. This issue would be best addressed in the context of that study, where it can be considered as part of a balanced proposal.**

One issue that could perhaps be addressed in the current study is the inappropriateness of burying such a substantive rule in the middle of a long definition. It might be possible to move the sentence to a more appropriate location, without creating any controversy. For example, the provision could be moved to the article on "Accounting" in the "Finances" chapter, thus:

> 5505. Financial statements in an association's balance sheet, income and expense statement, budget comparison, and general ledger shall be prepared in accordance with an accrual or modified accrual basis of accounting.
>
> **Comment**. Section 5505 restates the substance of the last paragraph of former Section 1365.2(a)(1)(C).

Should a change along those lines be made?

☞ *Manager Disclosure Statements*

Kazuko Artus suggests that the definition of "association records" be revised to add another type of document: the "managers' disclosure statements required by Bus. & Prof. Code § 11504." See Memorandum 2010-36, Exhibit p. 59.

Business and Professions Code Section 11504 requires that a CID manager make specified disclosures to the board about the manager's professional status:

> 11504. On or before September 1, 2003, and annually thereafter, a person who either provides or contemplates providing the services of a common interest development manager to an association shall disclose to the board of directors of the association the following information:
>
> (a) Whether or not the common interest development manager has met the requirements of Section 11502 so he or she may be called a certified common interest development manager.

(b) The name, address, and telephone number of the professional association that certified the common interest development manager, the date the manager was certified, and the status of the certification.

(c) The location of his or her primary office.

(d) Prior to entering into or renewing a contract with an association, the common interest development manager shall disclose to the board of directors of the association or common interest development whether the fidelity insurance of the common interest development manager or his or her employer covers the current year's operating and reserve funds of the association. This requirement shall not be construed to compel an association to require a common interest development manager to obtain or maintain fidelity insurance.

(e) Whether the common interest development manager possesses an active real estate license.

This section may not preclude a common interest development manager from disclosing information as required in Section 1363.1 of the Civil Code.

It does seem reasonable that the members of an association should have access to these disclosures. Although members may not be directly involved in selecting a property manager, their interests are affected by such a selection. Furthermore, the board is ultimately accountable to the members for the decisions that it makes. The staff sees no good reason to keep information disclosed under Section 11504 secret.

If the Commission agrees that this type of disclosure should be subject to inspection by the members, then the same should probably be true of the managing agent disclosure made pursuant to proposed Section 5375, which involves a similar type of disclosure by a *prospective* managing agent. If member oversight of board decision making requires transparency as to the status of a *chosen* property manager, it arguably also requires transparency as to the status of those who were *not* chosen.

This issue could be addressed by adding a new paragraph to proposed Section 5200(a), as follows:

5200. For the purposes of this article, the following definitions shall apply:

(a) "Association records" means all of the following:

…

(13) A disclosure provided pursuant to Section 5375 of this code or Section 11504 of the Business and Professions Code.

(Ordinarily, "of this code" would not be required, but in this context it would probably help to avoid confusion.)

Should a change along these lines be made?

Privileged Contracts

The definition of "association records" includes: "Executed contracts not otherwise privileged under law." See proposed Section 5200(a)(4).

Proposed Section 5215, which relates to the withholding or redacting of information in otherwise inspectable records, reiterates the exception for privileged contracts in the provisions excerpted below:

> 5215. (a) Except as provided in subdivision (b), the association may withhold or redact information from the association records if any of the following are true:
>
> …
>
> (3) *The information is privileged under law. Examples include documents subject to attorney-client privilege or relating to litigation in which the association is or may become involved, and confidential settlement agreements.*
>
> …
>
> (5) The information contains any of the following:
>
> …
>
> (D) Agendas, minutes, and other information from executive sessions of the board as described in Article 2 (commencing with Section 4900), *except for executed contracts not otherwise privileged. Privileged contracts shall not include contracts for maintenance, management, or legal services.*
>
> …
>
> (b) *Except as provided by the attorney-client privilege*, the association may not withhold or redact information concerning the compensation paid to employees, vendors, or contractors. Compensation information for individual employees shall be set forth by job classification or title, not by the employee's name, social security number, or other personal information.

Kazuko Artus strongly suggests that the last sentence of proposed Section 5215(a)(5)(D) be duplicated in proposed Section 5200(a)(4), thus:

> 5200. For the purposes of this article, the following definitions shall apply:
>
> (a) "Association records" means all of the following:
>
> …
>
> (4) Executed contracts not otherwise privileged under law. <u>Privileged contracts shall not include contracts for maintenance, management, or legal services.</u>

See Memorandum 2010-36, Exhibit p. 59. Ms. Artus first raised this issue in 2009 and the staff recommended against making any change at that time, expressing concern that any change "might disturb an intended meaning." See Memorandum 2009-44, p. 26. Ms. Artus notes that the Commission has not received any comments expressing support for the staff's concern. See Memorandum 2010-36, Exhibit p. 59.

Nonetheless, the staff continues to be concerned about making any changes to the privilege provisions. The meaning and purpose of those provisions is not entirely clear. Given that lack of clarity, even a seemingly innocuous revision might result in an unintended substantive change.

For example, proposed Section 5215(a)(3) provides that a record that is "privileged under law" is not subject to member inspection. It then goes on to provide examples of documents that are "privileged under law," including a document "relating to litigation in which the association is or may become involved." Plainly, it is not correct to state that all documents that relate to litigation are covered by the evidentiary privileges stated in the Evidence Code. Perhaps "privileged under law" does not refer to traditional evidentiary privileges. Perhaps the term is being used in a special sense to refer to matters considered in executive session? If so, then the language in proposed Section 5215(a)(5)(D) might have some special significance, limited to executive session records, that should not be generalized to apply to all contracts.

Given uncertainties of this type, the staff recommends against changing the language in the proposed law.

Litigation Accounting

Proposed Section 5520(b) would continue an existing requirement that an association account for reserve funds used to pay for litigation expenses, thus:

> 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.

The RPLS Working Group suggests that this accounting be added to the definition of "association records." See Memorandum 2010-36, Exhibit p. 154.

This is a good suggestion. It would not change the substance of existing law at all, since the accounting is *already expressly subject to member inspection*. But it would make the law easier to use by making the list of inspectable records more

complete. **The staff recommends that a paragraph be added to proposed Section 5200(a), as follows:**

> 5200. For the purposes of this article, the following definitions shall apply:
> (a) "Association records" means all of the following:
> …
> (14) An accounting prepared pursuant to subdivision (b) of Section 5520.

Membership List

Proposed Section 5200(a)(9) provides that the "membership list" is a type of "association record." The RPLS Working Group suggests revising that provision to acknowledge an existing rule that permits members to opt out of the membership list that is subject to member inspection. See Memorandum 2010-36, Exhibit p. 154; proposed Section 5220 (membership list opt out).

The proposed addition would be redundant, but would probably help to avoid any dispute about the interrelationship between the two provisions. **The staff recommends that the following revision be made**:

> 5200. For the purposes of this article, the following definitions shall apply:
> (a) "Association records" means all of the following:
> …
> (9) Membership lists, including name, property address, and mailing address, but not including information for members who have opted out pursuant to Section 5220.

Enhanced Association Records

Proposed Section 5200(b) would continue the existing definition of the term "enhanced association records," thus:

> "Enhanced association records" means invoices, receipts and canceled checks for payments made by the association, purchase orders approved by the association, credit card statements for credit cards issued in the name of the association, statements for services rendered, and reimbursement requests submitted to the association.

That term is only used in one provision: proposed Section 5205(g) permits an association to recover some costs of redacting "enhanced association records."

The RPLS Working Group suggests adding a note explaining the significance of the term. See Memorandum 2010-36, Exhibit p. 155. It would not be

appropriate to do so in the statute itself, but the Commission's Comment could be revised along the following lines:

> Subdivision (b) continues former Section 1365.2(a)(2) without change, except that a substantive rule providing that a person submitting a reimbursement request is "solely responsible for removing all personal identification information from the request" is not appropriate for inclusion in a definition and has been relocated, without substantive change, to Section 5205(g). For more information about the significance of the term "enhanced association records," see Section 5205(g) generally.

The staff sees no significant downside to adding a pointer of that type, and there might be some benefit. **On balance, the staff recommends that the change be made.**

Minutes of Committees

The RPLS Working Group notes that certain committees deal with matters that are private and involve only a single member's interest (e.g., a disciplinary committee or an architectural review committee). The minutes of those committees may include matters that should not be subject to member inspection. See Memorandum 2010-36, Exhibit p. 157.

This issue may already be adequately addressed by proposed Section 5215(a)(5), which protects disciplinary records and individual architectural plans. **It is not clear that anything further is required.**

Comment Correction

The RPLS Working Group points out an inadvertently omitted word in the Comment to proposed Section 5200. See Memorandum 2010-36, Exhibit p. 155. **This technical error will be corrected in the next version of the proposed law.**

Inspection and Copying

Proposed Section 5205 would continue existing rules governing the inspection and copying of association records by members. Those rules have drawn considerable criticism, as discussed below.

Designation of Agent

Subdivision (b) permits a member to designate an agent to inspect the records on the member's behalf. The RPLS Working Group objects that this opens the door to inspection of records by a non-member whose purpose may be adverse

to the welfare of the association. See Memorandum 2010-36, Exhibit p. 156. They suggest that the provision authorizing designation of an agent be deleted.

In the staff's view this would be a controversial and problematic change. Suppose that a disabled senior is concerned about mismanagement. She can't physically inspect the records herself, so she hires an accountant to inspect certain records and provide a report. That would seem to be appropriate and unproblematic. The staff is not persuaded that it makes sense to cut off access to such persons in order to prevent the possibility that inspection authority will be delegated to a person who abuses that authority.

Cost Recovery

Proposed Section 5205(f)-(g) govern cost recovery by the association:

> (f) The association may bill the requesting member for the direct and actual cost of copying and mailing requested documents. The association shall inform the member of the amount of the copying and mailing costs, and the member shall agree to pay those costs, before copying and sending the requested documents.
>
> (g) In addition to the direct and actual costs of copying and mailing, the association may bill the requesting member an amount not in excess of ten dollars ($10) per hour, and not to exceed two hundred dollars ($200) total per written request, for the time actually and reasonably involved in redacting the enhanced association record. If the enhanced association record includes a reimbursement request, the person submitting the reimbursement request shall be solely responsible for removing all personal identification information from the request. The association shall inform the member of the estimated costs, and the member shall agree to pay those costs, before retrieving the requested documents.

Comments on the provisions include:

- What is meant by "direct and actual cost of copying and delivery"? Is it just the cost of reproduction and mailing or can it include labor costs and contractor profit? Does it include time spent researching and compiling records? See Memorandum 2010-36, Exhibit pp. 59-60.
- In subdivision (f), the requirement that a member "agree to pay" should be replaced with a requirement that the member pay in advance. In addition, the payment language in subdivisions (a), (f), and (g) should be better coordinated, to avoid overlaps. See Memorandum 2010-36, Exhibit pp. 156, 159, 212-13.
- Subdivision (g) should be eliminated. See Memorandum 2010-36, Exhibit pp. 60, 159.

- The limit on recovery of redaction costs should be raised. See Memorandum 2010-36, Exhibit pp. 156, 213.
- In subdivision (g), what is meant by a "reimbursement request?" See Memorandum 2010-36, Exhibit p. 156. (The staff believes that the term is referring to an expense claim submitted by an agent or employee of the association.) The provision on redaction of information from a reimbursement request is unworkable. See Memorandum 2010-36, Exhibit p. 213.

Whatever their merits, the proposed issues are either too controversial or too complicated to be addressed in the proposed law. Such significant and substantive changes should be considered as part of a separate study.

Time Periods for Inspection

Proposed Section 5210 would continue existing law on the time period during which records are subject to member inspection, and the deadline for response to a member record inspection request. We received a number of comments on this provision.

Minutes of Committee Meeting

Proposed Section 5210(b)(5) governs the time for response to a request to inspect the minutes of a meeting of a committee with decision making authority (15 calendar days after approval of the minutes).

The RPLS Working Group and CACM both suggest that the provision be revised to address a related (but separate) substantive issue: who must *approve* committee minutes. The two groups suggest that the committee itself should approve its own minutes. See Memorandum 2010-36, Exhibit pp. 157, 213.

The staff is not certain that, in all cases, a committee would approve its own minutes. It is possible that an association's governing documents might require a committee's minutes to be approved by the board of directors, especially if the committee is exercising delegated board authority. If that is the case, why preclude such arrangements? What policy purpose would be served by imposing a statutory rule on the issue?

The RPLS Working Group also expresses concern that the concept of "decision making authority" is not as clear as it should be. For example, the decision of an architectural committee is subject to review and reversal by the board of directors. Does the architectural committee have "decision making authority?" *Id*.

The RPLS Working Group suggests replacing the term with language drawn from Corporations Code Section 7212, which instead refers to a committee "exercising the authority of the board." *Id*.

The problem is that there may be committees that have independent authority under a CID's governing documents and do not rely on authority delegated to them by the board of directors. In those cases, the proposed revision would seem to substantively narrow the scope of member inspection rights (by excluding committees that have independent authority).

The staff believes that the issues discussed above require more study and public input than is practical in the context of the current study.

Timing of Payment and Delivery

The RPLS Working Group suggests that the law should be revised to provide that the time to respond to a record inspection request begins to run on payment of the copying cost, rather than on receipt of a request.

The staff believes the proposed substantive revision would be too controversial for inclusion in the proposed law. It should be noted for possible future study.

Time Period Too Short

In CACM's experience, the 10 business day period for providing access to current year records can sometimes be too short, especially if the request is large or the records are stored off-site. CACM suggests that the period be extended to 15 business days. See Memorandum 2010-36, Exhibit p. 213.

The staff believes the proposed substantive revision would be too controversial for inclusion in the proposed law. It should be noted for possible future study.

Withholding and Redaction

Proposed Section 5215 would continue existing law on the withholding or redaction of information in association records, under specified circumstances. Comments on the provision are discussed below.

Risk of Fraud

Proposed Section 5215(a)(2) authorizes the withholding of information if the release of that information "is reasonably likely to lead to fraud in connection with the association."

The RPLS Working Group suggests adding "or a member whose personal information is included in requested association records" to the end of that provision. This would extend the fraud risk rationale for redaction to include a risk of fraud involving a member. See Memorandum 2010-36, Exhibit p. 160.

The staff is not sure that the change is necessary. Proposed Section 5215(a)(1) already provides for the redaction of information to avoid identity theft, thus:

> 5215. (a) Except as provided in subdivision (b), the association may withhold or redact information from the association records if any of the following are true:
>
> (1) The release of the information is reasonably likely to lead to identity theft. For the purposes of this section, "identity theft" means the unauthorized use of another person's personal identifying information to obtain credit, goods, services, money, or property. Examples of information that may be withheld or redacted pursuant to this paragraph include bank account numbers of members or vendors, social security or tax identification numbers, and check, stock, and credit card numbers.

That provision may be sufficient to protect members from fraud.

What's more, the staff is unsure of the intended effect of the revision proposed by the RPLS Working Group. In their letter, the Group writes:

> In making this suggestion the Authors wish to emphasize that they do not favor any revision of this text that will imply or expressly provide that an association has a duty to redact personal information of members by allowing the association to withhold information on that basis. Instead the Authors support the current status of the law, namely that a member is responsible for redacting his/her personal information.

See Memorandum 2010-36, Exhibit pp. 159-60.

The staff does not find the issue to be as clear-cut as the comment above suggests. Although proposed Section 5215 is phrased as permissive, rather than mandatory (the association "may" redact for the stated purposes), it could be argued that the provision does create a duty to redact. (See, in particular, proposed Section 2015(c), which contemplates liability for a failure to redact pursuant to proposed Section 5215.) If proposed Section 5215 does create a duty to redact, then the proposed revision might well broaden the scope of that duty.

The staff believes that the issue requires more study and public input than is possible in the context of the current study. The issue should be noted for possible future study.

"Executed" Contracts

The RPLS Working Group points out an ambiguity in proposed Section 5215(a)(5), which declares that "executed contracts not privileged" are subject to inspection, notwithstanding the fact that they were considered in a closed meeting of the board. The group believes it is not clear whether an "executed" contract is a contract that has been signed by all parties or one that has been fully performed. They prefer the latter interpretation and suggest that the provision be revised to make that meaning clear. See Memorandum 2010-36, Exhibit p. 158.

The staff is unsure of the intended meaning of the term "executed" in this context. Because any resolution of the ambiguity would require choosing one substantive rule over another, it is possible that any revision would be controversial. For example, those who favor robust disclosure requirements would want to know about contracts that are binding but not yet fully performed. The proposed revision would preclude inspection of such contracts.

The staff believes that resolution of the issue would require more analysis and public input than is practical in the context of the current study. It should be noted for possible future study.

Confidentiality of Employee Compensation

Proposed Section 5215(b) would continue a provision requiring disclosure of employee compensation, so long as the information is provided by job classification rather than by employee name or other identifying personal information.

CACM observes that the attempt to protect individual privacy by providing information by job classification only will not work in associations that have only a few employees. CACM suggests that all compensation information should be private; because the employer is the association rather than individual members, the members have no need to know compensation information. See Memorandum 2010-36, Exhibit p. 214.

The RPLS Working Group makes the same point but also argues, without citing any specific authority on the point, that disclosure of compensation information may violate an employee's constitutional right to privacy. See Memorandum 2010-36, Exhibit p. 160.

The staff believes that the issue of employee compensation disclosure raises significant legal and policy questions that would require more study and public input to resolve than is practical in the context of the current study. CIDs have

some characteristics of local government and other characteristics of private corporations. To what extent are public employee salaries publicly disclosed? To what extent are corporate officer salaries disclosed? How should privacy and accountability be balanced in those contexts? **The issue should be noted for possible future study.**

☞ *Immunity for Failure to Redact*

Proposed Section 5215(c) would provide:

> No association, officer, director, employee, agent, or volunteer of an association shall be liable for damages to a *member* of the association or *any third party* as the result of identity theft or other breach of privacy because of the failure to withhold or redact *that member's* information under this section unless the failure to withhold or redact the information was intentional, willful, or negligent.

(Emphasis added.)

Both CACM and the RPLS Working Group point out what may be an inadvertent gap in the coverage of this provision. Although the language provides immunity for damages to a "member" or a "third party," the section only refers to damages that result from a failure to withhold or redact "that member's" information. Both groups think the immunity should also extend to a failure to withhold or redact *a third party's* information. See Memorandum 2010-36, Exhibit pp. 158-59, 214.

There may well be an error in the provision. It seems unlikely (though not impossible) that a third party would ever be injured by an association's failure to redact personal information about one of its *members*. It seems much more likely that a third party would be injured by the association's failure to redact the third party's information. For example, an association's failure to redact an employee's social security number, as required by proposed Section 5215(b), could injure the employee.

The staff believes that the policy of the immunity provision would be better implemented if subdivision (c) were revised as follows:

> No association, officer, director, employee, agent, or volunteer of an association shall be liable for damages to a member of the association or any third party as the result of identity theft or other breach of privacy because of the failure to withhold or redact that member's or third party's information under this section unless the

> failure to withhold or redact the information was intentional, willful, or negligent.

However, that would be a substantive change. **It would therefore be prudent to invite public comment before making any decision on whether to make the change.**

"Illusory" Immunity

Proposed Section 5215(c) purports to immunize a person for failure to redact association records, "unless the failure to withhold or redact the information was intentional, willful, or negligent." The RPLS Working Group describes the immunity conferred by that provision as "illusory," because it includes "negligence" as a basis for liability. See Memorandum 2010-36, Exhibit p. 160.

The Commission has previously discussed the oddity of an "immunity" provision that does not preclude liability for simple negligence. After discussing public comments for and against changing the immunity language, the staff wrote:

> The staff has learned informally that the issue discussed above was expressly raised during the legislative process, but did not result in any change to the language. This suggests that liability for mere negligence was specifically intended, despite the odd phrasing of the provision.
>
> **The staff recommends that the language be continued without change.** There is no clear consensus for change, and the rule seems to reflect a deliberate policy choice by the Legislature.

See Memorandum 2007-55, pp. 21-22 (emphasis in original).

The staff continues to believe that the issue is too controversial to be addressed in the current study. The issue should be noted for possible future study.

Membership List Opt Out

Proposed Section 5220 would continue existing provisions that permit a member to "opt out" of disclosure of the member's address information when the association's membership list is disclosed, thus:

> 5220. A member of the association may opt out of the sharing of that member's name, property address, and mailing address by notifying the association in writing that the member prefers to be contacted via the alternative process described in subdivision (c) of Section 8330 of the Corporations Code. This opt-out shall remain in effect until changed by the member.

Enforcement Mechanism

Kazuko Artus asks what consequence there is to an association that violates the opt out provision. See Memorandum 2010-36, Exhibit p. 60.

There is no existing provision of the Davis-Stirling Act that provides a specific remedy for a violation of the opt out provision. However, the proposed law would add a new section (proposed Section 5980) that would authorize a member to file a civil action in the superior court to enforce *any* provision of the Davis-Stirling Act, including proposed Section 5220.

Revocation Procedure

CACM notes that the provision requires a written notice in order to exercise the opt out right, but says nothing about the method used to revoke an opt out request. They suggest that such a request also be in writing. See Memorandum 2010-36, Exhibit p. 214.

That is a reasonable suggestion, that would seem to provide better guidance on how to administer the opt out provision, without causing any significant increase in cost or hassle. What's more, a written revocation would be less likely to produce miscommunication and disputes. Although the proposed change would be substantive, it would appear to be uncontroversial, straightforward and salutary. **The staff recommends that the change be made.** See proposed Section 5260(d), under "Mailing List Requests," below.

Enforcement

Proposed Section 5235 would continue existing provisions governing judicial enforcement of the record inspection provisions, thus:

> 5235. (a) A member may bring an action to enforce that member's right to inspect and copy the association records. If a court finds that the association unreasonably withheld access to the association records, the court shall award the member reasonable costs and expenses, including reasonable attorney's fees, and may assess a civil penalty of up to five hundred dollars ($500) for the denial of each separate written request.
>
> (b) A cause of action under this section may be brought in small claims court if the amount of the demand does not exceed the jurisdiction of that court.
>
> (c) A prevailing association may recover any costs if the court finds the action to be frivolous, unreasonable, or without foundation.

Both the RPLS Working Group and CACM see significant ambiguity as to the meaning of "each separate written request" in subdivision (a). The term is important, because a separate penalty can be assessed for the denial of each separate written request. CACM urges the Commission to eliminate the ambiguity. See Memorandum 2010-36, Exhibit pp. 161, 214.

The staff sees CACM's point. A provision authorizing the imposition of penalties should be as clear as possible in defining what constitutes a separate violation. Otherwise, similar conduct could be treated differently by different courts, which could be unfair.

However, the issue is potentially complicated and controversial. Any "clarification" that is perceived as a substantive narrowing of the grounds for punishment would likely be opposed by those who favor strong remedies for violations of the Davis-Stirling Act. What's more, the definition of a "written request" to inspect records should probably be considered in a broader context. For example, what is the meaning of "written request" in proposed Section 5205(g), which limits the amount that an association can recover for the cost of redaction in a single "written request?"

Notwithstanding the importance of the issue, the staff believes that it requires more study and public input than is possible in the context of the current study. The issue should be noted for possible future study.

Cost and Fee Awards

The RPLS Working Group objects to the asymmetrical treatment of fees and costs in proposed Section 5235. In an action to enforce the record inspection provisions, any prevailing *member* is to be awarded fees and costs. By contrast, a prevailing *association* is only awarded fees and costs if the court finds that the member's action was "frivolous, unreasonable, or without foundation." The RPLS Working Group believes that the statute should award fees and costs to any prevailing party. See Memorandum 2010-36, Exhibit p. 162.

The existing asymmetry appears to be the result of a conscious legislative choice. **Any substantive change to that approach would be too controversial for inclusion in the proposed law. It should be noted for possible future study.**

Application of Record Inspection Provisions

Proposed Section 5240 would collect a number of rules governing the application of the record inspection provisions, thus:

5240. (a) As applied to an association and its members, the provisions of this article are intended to supersede the provisions of Sections 8330 and 8333 of the Corporations Code to the extent those sections are inconsistent.

(b) Except as provided in subdivision (a), members of the association shall have access to association records, including accounting books and records and membership lists, in accordance with Article 3 (commencing with Section 8330) of Chapter 13 of Part 3 of Division 2 of Title 1 of the Corporations Code.

(c) The provisions of this article apply to any community service organization or similar entity that is related to the association, and this article shall operate to give a member of the community service organization or similar entity a right to inspect and copy the records of that organization or entity equivalent to that granted to association members by this article.

(d) The provisions of this article shall not apply to any common interest development in which separate interests are being offered for sale by a subdivider under the authority of a public report issued by the Department of Real Estate so long as the subdivider or all subdividers offering those separate interests for sale, or any employees of those subdividers or any other person who receives direct or indirect compensation from any of those subdividers, comprise a majority of the directors. Notwithstanding the foregoing, this article shall apply to that common interest development no later than 10 years after the close of escrow for the first sale of a separate interest to a member of the general public pursuant to the public report issued for the first phase of the development.

The RPLS Working Group has a number of comments on proposed Section 5240.

Relationship to Corporations Code Provisions

Proposed Section 5240(a) makes clear that the Davis-Stirling Act record inspection provisions supersede the record inspection provisions of the Nonprofit Mutual Benefit Corporation Law, to the extent of any inconsistency.

Subdivision (b) then states that CID members have the record inspection rights provided in those Corporations Code provisions.

The RPLS Working Group suggests that subdivision (b) may be unnecessary, because the record inspection rights granted under the Davis-Stirling Act are both broader and more specific than the rights granted under the specified Corporations Code provisions. See Memorandum 2010-36, Exhibit p. 162.

It may not be quite that straightforward. Proposed Section 5240(d) exempts certain specified associations from the record inspection provisions of the Davis-

Stirling Act. If those associations are incorporated, they would continue to be subject to the record inspection provisions of the Corporations Code. Deletion of subdivision (b) might imply otherwise.

Given the conservative approach taken in preparing the proposed law, the staff recommends against deleting subdivision (b). It would be better to preserve an arguable redundancy, than to inadvertently narrow substantive rights.

Developer Controlled Board

Proposed Section 5240(d) would continue an existing exemption without substantive change:

> (d) The provisions of this article shall not apply to any common interest development in which separate interests are being offered for sale by a subdivider under the authority of a public report issued by the Department of Real Estate so long as the subdivider or all subdividers offering those separate interests for sale, or any employees of those subdividers or any other person who receives direct or indirect compensation from any of those subdividers, comprise a majority of the directors. Notwithstanding the foregoing, this article shall apply to that common interest development no later than 10 years after the close of escrow for the first sale of a separate interest to a member of the general public pursuant to the public report issued for the first phase of the development.

That provision is fairly complex, but boils down to an exemption from the record inspection provisions of the Davis-Stirling Act for an association that is still in a specified state of developer control (i.e., separate interests are still being sold, the developer controls a majority of the board, and it is less than ten years since the first sale of a separate interest).

The RPLS Working Group suggests restating the final sentence of the provision for clarity, thus:

> Notwithstanding the foregoing, this article shall apply to common interest developments in which the association board continues to be comprised of a majority of subdivider designees no later than 10 years after the close of escrow for the first sale of a separate interest to a member of the general public pursuant to the public report issued for the first or only phase of the development.

The staff is unsure whether that language would be any easier for laypeople to understand. Nor would it clearly resolve an existing ambiguity or other defect

in the statute. **Given the conservative approach taken in this study, the staff recommends against making the proposed revision.**

RECORD KEEPING

Duty to Maintain Records

Proposed Section 5250 would be new. It is intended to provide guidance on record retention for associations. It was crafted to be consistent with the existing periods during which records remain subject to member inspection and with general guidance on good management practices in nonprofit corporations. Comments on the provision are discussed below.

☞ *Separate Study*

CACM expresses general support for the intent of proposed Section 5250, but believes it would create new unanswered questions and intrude on the board's business judgment discretion. They suggest that the issue might be best addressed as a separate study, with more time to consider the appropriate categories of records to be retained and the appropriate retention periods. They also suggest adding language that would allow an association to rely on advice from counsel in determining which records must be retained and for how long. See Memorandum 2010-36, Exhibit p. 215.

In evaluating the comments discussed below, the Commission should keep in mind the option of deleting the record retention provisions entirely and noting them for possible future study. Recall that the retention provisions are new, so there is no obligation to include them.

☞ *Advisory Effect*

CACM suggests that proposed Section 5250 should be revised so that it provides guidance rather than imposing a mandatory legal duty. See Memorandum 2010-36, Exhibit p. 215.

There is a reasonable argument to be made for making the provision advisory, at least initially. The provision is new, having no analog in the Davis-Stirling Act or the Corporations Code. The issues addressed by the provision are very operational in character. The legal analysis that was conducted in preparing the provision may not sufficiently reflect *practical* considerations that should be taken into account in crafting an appropriate rule.

If the provision were made non-mandatory at first, it could be "field tested" by associations throughout the state. Any practical problems or gaps in the provision would likely be made known to the stakeholder groups, who could then communicate them to the Commission. This would provide the practical grounding needed to ensure that the provision's requirements are well tuned to reflect actual practice. The issue could then be revisited, with any appropriate adjustments made to the provision before making it mandatory. It is also possible that practical experience would show that a non-mandatory guidance provision is sufficient.

One factor that weighs in favor of this approach is the difficulty that the staff has had in finding good authorities that could be relied on in crafting the retention rules. The proposed section reflects the best information that could be found on the issue, but the staff has never been certain that there aren't other authorities that should also be taken into account. "Field testing" of the provision might help to identify such authorities.

On the other hand, the notion of adding merely advisory language to a statute might be so unusual as to cause confusion. Some might read the provision as creating a duty, notwithstanding the language used.

Although none of the comments on proposed Sections 5250 and 5255 expose any insurmountable problems in those provisions, the staff recommends that the Commission give consideration to making the provision advisory, as follows:

> **§ 5250 (NEW). ~~Duty to maintain records~~ Record retention**
>
> 5250. (a) An association ~~shall~~ should maintain at least one copy of the following association records, for the periods specified in Section 5255:
>
> …

This might be the most prudent way to introduce record retention provisions into the Davis-Stirling Act.

☞ *Membership List*

Proposed Section 5250(a)(2) would provide that the "membership list" is a record that must be maintained by the association.

CACM is concerned that the reference to the membership list might be confusing. Unlike many other association records, the membership list is not a static document. It can change, repeatedly. This raises the question of what is

meant by "the membership list." Is it the most recent version of the list? Must a copy of the list be separately archived every time there is a change to any entry? See Memorandum 2010-36, Exhibit p. 215.

This is a good point. It could be administratively burdensome to archive every version of the list. It is worth exploring alternatives. For example:

- One possibility would be to simply require retention of the current version of the list. Obsolete entries would not need to be retained.
- Another possibility would be require periodic "snapshots" to be archived (e.g., store a copy of the current membership list each July 1, and retain it for some specified retention period).

The first approach would be simplest to describe and administer. However, there might well be times when it would be helpful to retain obsolete address information. For example, a dispute might later arise about whether a particular document was mailed to a proper address. Resolution of such a dispute would require information about the address of record at the time of mailing.

Although it would add to the complexity of the provision, it is worth considering revising proposed Section 5250(a)(2) as follows:

> 5250. (a) An association shall maintain at least one copy of the following association records, for the periods specified in Section 5255:
>
> …
>
> (2) The current membership list, including the name, address, and membership class of each member. In addition, the association shall file a copy of the membership list annually, to provide a record of the content of the mailing list at the time of filing.

Pursuant to proposed Section 5255(a) (discussed below) the file copies of the mailing list would be retained for four years. **Should such a change be made?**

Enforcement Records

Proposed Section 5250(a)(17) would require retention of "[a] record that relates to enforcement of a restriction."

The RPLS Working Group believes that this might be overly broad. They question whether the provision should apply to informal compliance requests that stop short of formal discipline. See Memorandum 2010-36, Exhibit p. 163.

It seems clear that records relating to formal disciplinary proceedings should be retained, as they might become relevant in a subsequent judicial action challenging the association's disciplinary decision. It is less clear that informal

warnings need to be retained, if they never develop into a basis for formal disciplinary action. If there is no discipline, there is less likelihood that the records will have any later significance that would warrant their retention for an extended period of time.

However, informal compliance records might be relevant in a dispute alleging disparate or discriminatory treatment, with some members let off with a warning, while others are formally punished. Furthermore, it would seem to be good administrative practice for an association to keep records of informal compliance requests, so that it can determine whether a particular member has a prior history of violating restrictions. **Given those reasons for retention of informal disciplinary records, the staff is inclined against narrowing the provision.**

Deeds

Proposed Section 5250(a)(7) would require retention of "[a] deed or other record that relates to title of real property within the common interest development."

Duncan McPherson suggests that the provision be revised to make clear that it only applies to deeds to the common area. If a deed to a separate interest passes through the association's hands (e.g., in connection with a transfer), the association should not be required to retain a copy. See Memorandum 2010-36, Exhibit p. 70. The RPLS Working Group makes a similar point. See Memorandum 2010-36, Exhibit p. 162.

The staff agrees and recommends that the provision be revised to limit it to common area property, thus:

> A deed or other record that relates to title of real property within the common ~~interest development~~ area.

In some CIDs, the association does not own the common area (it is owned by the members as tenants in common). Nonetheless, even in those cases it would seem sensible to have the association, as the managing entity, maintain a copy of the title records in its files.

Mr. McPherson also questions the need for the association to retain deeds at all, since they are on record with the county recorder. See Memorandum 2010-36, Exhibit p. 70. Technically that is correct, but it would seem to be prudent to keep a copy in the association's files as well. Doing so would not be particularly

burdensome. **The staff would recommend against deleting the deed retention provision entirely.**

Technical Revisions

The RPLS Working Group makes two technical drafting suggestions:

- Revise proposed Section 5250(a)(6) along these lines: "~~A~~ An association tax return or other tax-related record."
- Revise proposed Section 5200(a)(15) to make clear whether it applies to every election, or just a director election.

See Memorandum 2010-36, Exhibit p. 162.

The staff recommends that the first suggested revision be made. There is no reason to require that an association retain the tax records of any entity other than itself. The proposed revision would help to avoid any confusion on this point.

Regarding the second suggestion, the staff does not see any ambiguity in proposed Section 5200(a)(15), which refers to "an election" without any limitation as to the type of election:

> A ballot, proxy, or other record that relates to an election.

That breadth seems appropriate. Any member election is important and can potentially be challenged on the grounds of fraud or procedural defects. If an election is challenged, it is important that the ballots, proxies, and other materials related to the conduct of the election be available as evidence.

However, there is one minor revision that might be helpful:

> A ballot, proxy, or other record that relates to ~~an~~ a member election.

That would help to avoid any dispute about whether "election" should include a vote of the board of directors or other representative body other than the members. That was not the intent of the provision. **The staff recommends that the revision set out above be made.**

Retention Periods

Proposed Section 5255, which is also new, provides default retention periods for various types of records. Comments on the provision are discussed below.

☞ *Continuing Operational Effect*

Proposed Section 5255(a) draws a distinction between records in general and records that have a "continuing legal or operational effect." The former must be retained for four years after the date of creation. The latter must be retained for four years after termination of the record's effect. Thus:

> Unless a longer period is required by law or by the governing documents, an association shall retain a record listed in Section 5250 for at least four years after its date of creation, except that a record with continuing legal or operational effect shall be retained during the period of its effect and for at least four years after the termination of its effect.

Both the RPLS Working Group and CACM believe that the concept of continuing operational effect will be difficult for non-lawyers to understand. See Memorandum 2010-36, Exhibit p. 163, 215.

That may well be correct. The concept is not simple, and the Commission struggled with how to succinctly express it. Perhaps the meaning of the provision would be clearer if it were recast to read:

> Unless a longer period is required by law or by the governing documents, an association shall retain a record listed in Section 5250 for at least four years after its date of creation, or four years after the termination of the record's effect, whichever is later.

The Comment to proposed Section 5255(a) could be revised to provide examples, thus:

> **Comment**. Section 5255 is new. Subdivision (a) states a default retention period, but makes clear that other law or an association's governing documents may impose a longer retention period. ~~A special rule is provided for records that have "continuing legal or operational effect." Such records might include a lease or other contract with a fixed term.~~ Ordinarily a record governed by this subdivision must be retained for four years after the date that the record is created. However, if a record has some continuing effect over time (e.g., a one-year service contract), then the record must be retained for four years after the termination of the record's effect (e.g., the termination date of a service contract). Associations should determine whether administrative agencies, such as the Franchise Tax Board or Internal Revenue Service, impose longer retention requirements for some records.

Should a change along these lines be made?

☞ *Design and Construction Records*

Proposed Section 5255(b)(4) requires the permanent retention of: "A record that relates to the design, construction, or physical condition of the common interest development."

The RPLS Working Group questions the need to permanently retain such documents, especially if the provision were construed to include records relating to architectural review of separate interest modifications. See Memorandum 2010-36, Exhibit p. 163.

The permanent retention requirement was proposed because of the very long statute of limitations that governs some construction defect claims. See Code Civ. Proc. § 337.15 (10-year limitation period for latent defects). That said, it might be sufficient to require that such records only be retained for 10 years, rather than permanently, thus:

> (b) The association shall retain the following records permanently:
>
> …
>
> ~~(4)~~ (c) A record that relates to the design, construction, or physical condition of the common interest development shall be retained for 10 years.

Should such a change be made?

The concern about the lengthy statute of limitations for a construction defect claim does not apply to records relating to an association's review of a proposed separate interest modification. Architectural review is a standard part of association governance. Records produced in conducting architectural review should have the same four-year retention period as other governance documents. If the Commission agrees, proposed Section 5255(b)(4) could be revised as follows:

> (b) The association shall retain the following records permanently:
>
> …
>
> (4) A record that relates to the design, construction, or physical condition of the common interest development. This paragraph does not apply to a record that relates to association review of a member's proposal to modify the member's separate interest.

Should such a change be made?

Prospective Application

Proposed Section 5255(d) would provide that the retention requirements have no application to a record that is discarded or destroyed prior to the anticipated operative date of the proposed law:

> This section does not apply to a record that is discarded or destroyed before January 1, 2013.

The RPLS Working Group is concerned that this provision implies that an association or its agents could be held liable for discarding or destroying a record, in violation of the retention requirements, on or after January 1, 2013. The Group maintains that many records are lost accidentally, through no fault of the volunteer board. The Group urges the addition of an express statement of non-liability. See Memorandum 2010-36, Exhibit p. 163.

Before turning to the substance of the concern, please note that this issue would be moot if the retention provisions were made advisory, rather than mandatory, as discussed above. In that case, proposed Section 5255(d) could be deleted without consequence.

On the merits of the issue, the staff is not sure how a provision precluding retroactive application of new requirements would imply any special liability for a violation of the requirements. The record retention requirements would be just another element of required governance practice, with no particular guidance or emphasis on the consequences for noncompliance. Contrast this with other provisions of existing law, that expressly provide for penalties for noncompliance with specified governance procedures. See, e.g., proposed Section 5235 (fee shifting and civil penalty for violation of record inspection provisions). For that reason, the staff is skeptical of the need for any express limitation on liability.

Furthermore, the staff is not convinced that blanket immunity from liability in all cases would be good policy. Courts have no reason to impose liability on boards for blameless conduct. If a board acts so egregiously that a court finds reason to penalize them in some way, why preclude that result?

For the reasons stated above, the staff recommends against adding immunity language to proposed Section 5255.

☞ Mailing List Requests

As noted in a prior memorandum, we received comments suggesting that a writing be required when submitting certain requests relating to the association's mailing list. See, e.g., First Supplement to Memorandum 2010-39, pp. 8 (request for change of address), 10 (request for mailing to two addresses), 13 (request for individual delivery of "general notices").

At the time, the staff recommended that consideration of those issues be deferred, because it might be possible to address such matters globally, in connection with the provisions governing association records. We pick up that thread in this memorandum.

The staff agrees that a writing should generally be required whenever making a request that will effect the content or use of the membership list. This would provide a record that could be used to avoid (or resolve) disputes over whether and when a member requested membership list change.

This issue could be addressed by adding a provision along the following lines:

> **§ 5260 (added). Mailing list requests**
>
> 5260. To be effective, any of the following requests shall be delivered in writing to the association, pursuant to Section 4035:
>
> (a) A request to change the member's information in the association membership list.
>
> (b) A request to add or remove a second address for delivery of individual notices to the member, pursuant to subdivision (b) of Section 4040.
>
> (c) A request for individual delivery of general notices to the member, pursuant to subdivision (b) of Section 4045, or a request to cancel a prior request for individual delivery of general notices.
>
> (d) A request to opt out of the membership list pursuant to Section 5220, or a request to cancel a prior request to opt out of the membership list.
>
> (e) A request to receive a full copy of a specified annual budget report or annual policy statement pursuant to Section 5320.
>
> (f) A request to receive all reports in full, pursuant to subdivision (b) of Section 5320, or a request to cancel a prior request to receive all reports in full.
>
> **Comment**. Section 5260 is new. It requires that the specified requests be written and delivered to the association pursuant to Section 4035.

The staff believes that a provision along those lines would be helpful and uncontroversial. **Should such a provision be added?**

Existing law requires that an association prepare an annual pro forma operating budget and provide it to the members, in a specified time frame. Other specified information must also be provided with the budget. Over time, further annual disclosures have been added to the Davis-Stirling Act, and tacked on to the annual budget report, in piecemeal fashion.

The proposed law would reorganize those requirements so that the various disclosures are divided into two distinct documents:

(1) The "annual budget report," which includes information about the association's budget, reserves, outstanding loans, and insurance. See proposed Section 5300.
(2) The "annual policy report," which includes miscellaneous information about association policy. See proposed Section 5310.

Under the proposed law, an association may send notice of the availability of these reports, along with a summary of their contents, rather than the reports themselves. These notices must inform the members of their rights to receive a copy of the reports at no cost. See proposed Section 5320. This notice of availability approach is based on existing law. See Section 1365(d).

The purpose of this reorganization of the annual reporting requirements is to maximize flexibility (with the goal of reducing costs), while maintaining the substance of existing law.

Comments on this approach are discussed below.

Location

The RPLS Working Group suggests moving the entire "Annual Reports" article to the chapter on "Finances." See Memorandum 2010-36, Exhibit p. 164.

There is some merit to that suggestion, as many of the items disclosed in the reports relate to financial planning and disclosures. However, the reports also include material on non-financial matters (e.g., dispute resolution procedures). Because the reports would address a variety of topics, there is no single location that would be perfectly suitable. **For that reason, the staff does not see sufficient reason to move the provisions.**

Content of Annual Budget Report

Duncan McPherson and the RPLS Working Group make a number of suggestions for improvement of proposed Section 5300, which specifies the content of the annual budget report.

Timing

The proposed section would require that an association "prepare and distribute" the annual budget report "30 to 90 days before the end of its fiscal year."

The RPLS Working Group is concerned that this language might be read to limit the time during which the budget may be *prepared*. They suggest that the language only require *distribution* of the report in the specified time period. See Memorandum 2010-36, Exhibit p. 164.

This is a good point. The existing language that is the source of proposed Section 5300 only uses the word "distribute." See Section 1365(a) (last paragraph). **The staff recommends that "prepare and" be deleted from the language.** This would be more consistent with the existing language and would avoid the timing problem noted by the RPLS Working Group.

Summary of the Reserve Funding Plan

Proposed Section 5300(b)(3) would continue, without substantive change, an existing requirement that the annual budget report include a "summary of the reserve funding plan":

> (b) Unless the governing documents impose more stringent standards, the annual budget report shall include all of the following information:
>
> …
>
> (3) A summary of the reserve funding plan adopted by the board, as specified in paragraph (5) of subdivision (b) of Section 5550. 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.

The RPLS Working Group suggests revising the provision as follows:

> (3) A summary of the reserve study and reserve funding plan commissioned and adopted by the board, as specified in paragraph (5) of subdivision (b) of Section 5550. The summary shall include notice to members that the full reserve study and reserve funding plan is available upon request, and the association shall provide the

full reserve study and reserve funding plan to any member upon request.

See Memorandum 2010-36, Exhibit p. 164.

Although the RPLS Working Group characterizes this as a nonsubstantive change, the staff believes that the proposed change would have a substantive effect. Under existing law (and the proposed law), the "reserve funding plan" is just one component of the "reserve study." See proposed Section 5550. Under existing law, the annual budget mailing is only required to include the reserve funding plan, not the entire reserve *study*. As indicated above, the members must be informed that the full reserve study is available on request.

The proposed revision would appear to substantively broaden the required disclosure, by requiring a summary of the entire reserve study.

The staff recommends against making such a substantive change without the opportunity for more analysis and public input than is practical in the current study.

On a related point, the RPLS Working Group suggests deleting proposed Section 5300(b)(6), which would provide as follows:

> (b) Unless the governing documents impose more stringent standards, the annual budget report shall include all of the following information:
>
> …
>
> (6) A statement as to the mechanism or mechanisms by which the board 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.

The RPLS Working Group correctly points out that paragraph (6) substantially duplicates the information required to be disclosed in the summary of the reserve funding plan, discussed above. See Memorandum 2010-36, Exhibit p. 165.

The Commission has expressed its intention to conduct a comprehensive review of the accounting and finance provisions of the Davis-Stirling Act. The purpose would be to examine those provisions as a whole, rather than make piecemeal changes in isolation. **The staff believes it would be best to address the overlap described above as part of that more general study.**

Technical Revisions

The RPLS Working Group suggests revising proposed Section 5300(b)(4) as follows:

> (b) Unless the governing documents impose more stringent standards, the annual budget report shall include all of the following information:
>
> …
>
> (4) A statement as to whether the board 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 or defer the repairs or replacement.

See Memorandum 2010-36, Exhibit p. 164. **The staff is not convinced this change is necessary.** The sentence already refers to a justification "for the deferral" *or* "decision not to undertake" repairs. It therefore seems that the language already covers the point that the RPLS Working Group wishes to emphasize.

The RPLS Working Group also suggests revising proposed Section 5300(b)(5) as follows:

> (b) Unless the governing documents impose more stringent standards, the annual budget report shall include all of the following information:
>
> …
>
> (5) A statement as to whether the board, consistent with the reserve funding plan adopted pursuant to ~~Section 5560~~ paragraph (5) of subdivision (b) of Section 5550 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.

See Memorandum 2010-36, Exhibit p. 165.

It isn't entirely clear which provision the reserving funding plan is "adopted pursuant to." Proposed Section 5550(b)(5) requires that the plan be adopted. Proposed Section 5560 prescribes the content of the plan. The staff sees no substantive problem or meaningful risk of confusion that could result from using one reference as opposed to the other. **For that reason, the staff is inclined to leave the provision unchanged.**

Duncan McPherson suggests revising proposed Section 5300(b)(7) as follows:

> (b) Unless the governing documents impose more stringent standards, the annual budget report shall include all of the following information:
>
> …
>
> (7) 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~~ statement shall include, but need not be limited to, reserve calculations made using the formula described in paragraph (4) of subdivision (b) of Section 5570, 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.

See Memorandum 2010-36, Exhibit p. 70.

The proposed revision would appear to be a nonsubstantive clarification. It seems almost certain that "report" (which is the term used in existing law), refers back to the "general statement" mentioned in the first sentence of the paragraph. **In order to promote standardized language and reduce the risk of confusion, the staff recommends that the change be made.**

Annual Financial Statement

Proposed Section 5305 would continue Section 1365(c), as follows:

> 5305. 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, by individual delivery pursuant to Section 4040.

Samuel Dolnick correctly points out an error in the provision. See Memorandum 2010-36, Exhibit p. 38. Existing Section 1365 begins with a general qualifier on the entire section that reads: "Unless the governing documents impose more stringent standards…." That qualifier currently applies to the financial statement provision that is continued in proposed Section 5305. It should have been reiterated in that provision, thus:

> 5305. ~~A~~ Unless the governing documents impose more stringent standards, 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, by individual delivery pursuant to Section 4040.

The staff strongly recommends that this change be made.

Annual Policy Statement

Proposed Section 5310 would provide for the distribution of an annual policy statement, which would aggregate existing annual disclosure requirements. We received a number of comments on the provision, which are discussed below.

"Annual Policy Statement"

The RPLS Working Group believes that the name of the document, "annual policy statement" is inappropriate, because some of the listed disclosures are not "policies." See Memorandum 2010-36, Exhibit p. 165.

That is correct. It might be more accurate to give the document a more general name (e.g., "annual information statement" or "annual disclosure document"). But the staff does not see any real problem with the name "annual policy statement." The name seems apt enough to capture the purpose of the document and avoid confusion. **The staff recommends against changing it.**

Reserve Funding Disclosure

The RPLS Working Group wonders why the annual policy statement does not include the reserve funding summary set out in proposed Section 5570. See Memorandum 2010-36, Exhibit p. 165.

That information would be included in the annual budget report, pursuant to proposed Section 5300(a)(2). That seems appropriate, as the annual budget report includes information of a financial nature, while the annual policy statement includes other miscellaneous disclosures.

Timing

The RPLS Working Group suggests that it would be more efficient if the time specified for delivery of the annual policy statement were revised to be the same as the time for delivery of the annual budget report. That way, the two documents could be mailed together if it would be more convenient to do so. See

Memorandum 2010-36, Exhibit p. 165. CACM makes a similar point. See Memorandum 2010-36, Exhibit p. 215.

This is a good suggestion. There is no policy reason for the documents to be on different schedules. **The staff recommends that proposed Section 5310 be revised to match the delivery deadline of the annual budget report, thus:**

> 5310. (a) ~~Within 120 days after the end of the~~ Within 30 to 90 days before the end of its fiscal year, the board shall prepare and distribute an annual policy statement that provides the members with information about association policies. The annual policy statement shall include…

Summary of "Alternative Dispute Resolution Procedure"

Proposed Section 5310(a)(9) would require that the annual policy statement include: "A summary of alternative dispute resolution procedures, pursuant to Section 5920 and 5965."

The RPLS Working Group objects that proposed Section 5920 relates to the association's "*internal* dispute resolution" procedure. While that could be characterized as a form of ADR in a more general sense of the term, it doesn't match perfectly with the terms of art used in the proposed law. See Memorandum 2010-36, Exhibit p. 165. The same point is made by Sun City Roseville and CACM. See Memorandum 2010-36, Exhibit pp. 43, 216.

The staff recommends that the revision be made, thus:

> (9) A summary of ~~alternative~~ dispute resolution procedures, pursuant to Sections 5920 and 5965.

Delivery to New Members

Proposed Section 5310(b) would be a new provision:

> (b) The board shall promptly deliver a copy of the most recent annual policy statement to any new member, at no cost to the member.

The RPLS Working Group objects to imposing this duty on the association. Among other reasons, they note that the seller of a separate interest is already required to provide a prospective purchaser with the most recent copies of the annual budget report and Annual Policy Report, pursuant to proposed Section 4525(a)(3). See Memorandum 2010-36, Exhibit pp. 165-66.

This is a good point. There is no reason to require the delivery of a second copy directly from the association. **The staff recommends that proposed Section 5310(b) be deleted as unnecessarily burdensome.**

Notice of Availability

Proposed Section 5320 would continue an existing procedure for distribution of the annual budget and generalize it so that it also applies to the proposed annual policy statement, thus:

> 5320. (a) When a report is prepared pursuant to Section 5300 or 5310, the association shall deliver one of the following documents to all members, by individual delivery pursuant to Section 4040:
>
> (1) The full report.
>
> (2) A summary of the report. The summary shall include a general description of the content of the report. Instructions on how to request a complete copy of the report at no cost to the member shall be printed in at least 10-point boldface type on the first page of the summary.
>
> (b) Notwithstanding subdivision (a), if a member has requested to receive all reports in full, the association shall deliver the full report to that member, rather than a summary of the report.

As can be seen, the provision *permits* an association to send a summary notice of a report's availability, rather than the full report. The summary would include instructions on how to obtain the full report at no cost. An association would remain free to send the full report, rather than a summary, if that makes sense for the association.

The RPLS Working Group wonders whether the provision will be of much practical benefit, given the difficulty of summarizing the information included in the reports. They suggest, as a possible streamlining change, requiring only that the annual budget report be summarized in a notice of availability. See Memorandum 2010-36, Exhibit p. 166.

The staff does not believe that it would be too difficult to summarize the content of the annual policy statement. Proposed Section 5310 does so in a single page. What's more, use of the summary notice procedure is optional. If an association finds the procedure unhelpful, it need not use it. **The staff is inclined against deleting the summary requirement for the annual policy statement.**

The RPLS Working Group also suggests requiring that any request made under this section be in writing. **The staff agrees with this suggestion.** See proposed Section 5260(e)-(f), under "Mailing List Requests," above.

The RPLS Working Group also objects to proposed Section 5320(b), which permits a member to give a standing instruction in advance, directing that all reports of a particular type be sent in full. "The association should be able to routinely distribute summaries, subject to the owner's right to make a written request and receive the full version of the document." See Memorandum 2010-36, Exhibit p. 166.

The staff disagrees with this suggestion on its merits. If a member tells an association that the member always wants to receive the full annual budget report, what purpose is served by sending that member a notice of availability and then requiring the member to submit a written request for the full report, year after year? The staff knows from its own experience that the proposed "standing order" provision would not be difficult to administer. We currently have a "check box" in our own mailing list to indicate whether a person is to receive a full copy of a tentative recommendation, or notice of the availability of the tentative recommendation. It adds very little administrative hassle, but allows us to streamline our mailings without shifting a new burden to the persons on our list.

Finally, CACM suggests that the provision is "new law," and should be deleted. They describe the budget report as a summary itself, suggesting that there would be little point in summarizing a summary. See Memorandum 2010-36, Exhibit p. 216.

Proposed Section 5320 is not "new law," at least with regard to the annual budget report. See Section 1365(d). It would generalize that existing procedure so that it also applies to the annual policy statement. **For that reason, and because the summary procedure is optional and so cannot create any new burden, the staff recommends against deleting the provision.**

CONFLICT OF INTEREST

Existing Section 1365.6 provides that an association director is subject to some of the same restrictions on interested decision making that govern a director of a for profit corporation:

> Notwithstanding any other law, and regardless of whether an association is a corporation, as defined in Section 162 of the Corporations Code, the provisions of Section 310 of the Corporations Code shall apply to any contract or other transaction authorized, approved, or ratified by the board or a committee of the board.

Proposed Section 5350 would continue the general substance of that provision, but would instead refer to the equivalent provision of the Nonprofit Mutual Benefit Corporation Law. The proposed section would also set out some common sense rules on the sorts of decisions that directors and committee members should not make, because of their self-interest in the result. This was intended to supplement the rules provided in the Corporations Code, in a form that would be easy for non-lawyers to understand. Thus:

> 5350. (a) Notwithstanding any other law, and regardless of whether an association is incorporated or unincorporated, the provisions of Sections [7233] and [7234] of the Corporations Code shall apply to any contract or other transaction authorized, approved, or ratified by the board or a committee of the board.
>
> (b) A director or member of a committee shall not vote or otherwise act on behalf of the association with respect to any of the following matters:
>
> (1) Discipline of the director or committee member.
>
> (2) An assessment against the director or committee member for damage to the common area or facilities.
>
> (3) A request, by the director or committee member, for a payment plan for overdue assessments.
>
> (4) A decision whether to foreclose on a lien on the separate interest of the director or committee member.
>
> (5) Review of a proposed physical change to the separate interest of the director or committee member.
>
> (6) A grant of exclusive use common area to the director or committee member.
>
> (c) Nothing in this section limits any other provision of law or the governing documents that governs a decision in which a director may have an interest.

(The bracketed numbers have been changed to correct a reference error. See Memorandum 2010-36, Exhibit p. 45.)

Comments on proposed Section 5350 are discussed below.

Reference to General Corporation Law

Lucille Findlay is concerned that the Comment language describing Corporations Code Section 310 as governing "for profit" corporations might be inaccurate. Further, she is concerned that deletion of the existing reference to a corporation as defined in Corporations Code Section 162, might create an implication that general corporation law doesn't govern nonprofit corporations. See Memorandum 2010-36, Exhibit p. 45.

Division 1 (commencing with Section 100) of Title 1 of the Corporations Code is known as the "General Corporations Law." It governs corporations formed under that division. See Corp. Code § 162 ("corporation" means corporation formed under Division 1).

Division 2 (commencing with Section 5000) of Title 1 of the Corporations Code is the "Nonprofit Corporation Law," which governs nonprofit corporations of various specified types.

While it appears that the two divisions are generally not intended to overlap in their application, there may be instances in which a provision of one applies to corporations formed under the other. To avoid any possible inaccuracy, the staff recommends revising the relevant portion of the Comment language as follows:

> **Comment**. Subdivision (a) of Section 5350 continues former Section 1365.6 without substantive change, except that the reference to Corporations Code Section 310, which governs ~~for-profit corporations~~ the General Corporation Law, has been replaced with a reference to Corporations Code Sections 7233 and 7234, which state equivalent rules for nonprofit mutual benefit corporations.
>
> …

☞ **Non-Voting Participation**

The RPLS Working Group points out that the Corporations Code permits some director participation in self-interested decision making, with specified limits. By contrast, the prohibitions stated in proposed Section 5350(b) are unqualified: a "director or member of a committee shall not vote or otherwise act on behalf of the association with respect to any of the [specified] matters." The RPLS Working Group invites the Commission to consider whether the scope of that prohibition should be made clearer. See Memorandum 2010-36, Exhibit pp. 166-67.

CACM raises a related point, asking why directors or committee members should be precluded from discussions of a specified matter (rather than just being precluded from casting a vote on the matter). See Memorandum 2010-36, Exhibit p. 216.

This is a reasonable policy question. Should the proposed law prohibit all participation in the specified types of self-interested decisions, or merely prohibit voting on those matters?

There is a good argument for prohibiting all participation. Many CIDs are small and run by nonprofessionals. In that sort of environment, a person with a

forceful personality may determine the outcome of a vote through argument or bullying, even if that person does not cast a vote formally. That sort of improper influence could be avoided through a blanket nonparticipation rule.

On the other hand, a broad nonparticipation rule could lead to misunderstanding and dispute. For example, the proposed law would not prohibit *all* participation, just participation "on behalf of the association." Thus, in a disciplinary hearing where the accused is a director, that director should be free to testify in his or her own defense, to the same extent as any other accused member. But the director should not be able to exercise any special authority granted to a director in the disciplinary hearing process. Would that distinction be understandable to lay persons? Or would it lead to arguments and uncertain results? A simple rule prohibiting voting would be much easier to understand and apply.

The staff believes that this requires further discussion.

☞ *Additional Disqualified Matter*

The RPLS Working Group "strongly" suggests adding another matter to proposed Section 5350(b), as follows:

> (b) A director or member of a committee shall not vote or otherwise act on behalf of the association with respect to any of the following matters:
>
> …
>
> (7) Whether or not to censure or sanction a director for intentional disclosure of confidential information or other breach of fiduciary duty.

The staff is not sure how common it is for a board to censure one of its members, but the suggestion makes sense on its face.

However, the staff wonders whether it is necessary, given proposed Section 5350(b)(1), which prohibits a director or committee member from participating in a matter involving "Discipline of the director or committee member." Wouldn't the new proposed topic be entirely subsumed within subdivision (b)(1)?

That said, redundancy is not always an evil. Sometimes it serves to emphasize a point. In this instance, the RPLS Working Group may be wanting to draw specific attention to matters where the board sanctions one of its own, for misconduct as a director, rather than the more general case where a director is disciplined for misconduct as a member.

Should the proposed language be added?

Legislative Process

CACM suggests generally that the expanded conflict rules in proposed Section 5350(b) would "benefit from the legislative process." See Memorandum 2010-36, Exhibit p. 216. This may be advance notice that CACM (or others) may want to raise new issues concerning proposed Section 5350(b) after a bill has been introduced.

Obviously, it would be more efficient to consider any new issues at this time, in the hopes of resolving them before the legislative process. However, the provision would be new substantive law, and the Commission should not be surprised if it draws broader attention once it is expressed in bill form.

MANAGING AGENT

Proposed Section 5380 would continue existing rules regulating the deposit of funds by managing agents. Ravi Kapoor suggests revising the provision to require the involvement of at least two directors in the management of a trust account containing association funds. See Memorandum 2010-36, Exhibit p. 85.

The staff believes that such a significant substantive change should not be made without thorough public review and comment, beyond what is practical in the context of the current study. The issue should be noted for possible future study.

GOVERNMENTAL ASSISTANCE

Proposed Section 5405 would continue an existing provision that requires an association to register with the Secretary of State. The provision requires, amongst other things, that the association disclose:

> The name, address, and either the daytime telephone number or e-mail address of the president of the association, other than the address, telephone number, or e-mail address of the association's onsite office or managing agent.

Proposed Section 5405(a)(4).

Duncan McPherson asks whether the provision should require "a" daytime telephone number, rather than "the" daytime telephone number. See Memorandum 2010-36, Exhibit p. 70. The same issue exists in subdivision (a)(5).

While the staff sees Mr. McPherson's point, the existing language is not plainly erroneous. **Given the Commission's conservative drafting approach in this study, the staff recommends against making the suggested change.**

GENERAL OPPOSITION TO THE PROPOSED LAW

George K. Staropoli demands that the Commission "cease and desist" its work on the current study. He has strong objections to the current legal treatment of CIDs, and apparently opposes any reform of the Davis-Stirling Act that would not implement his preferred approach (he believes associations should be organized as public entities, rather than private entities). See Exhibit pp. 5-7.

CONCLUSION

This memorandum discusses more than 100 suggestions for change to the proposed law. Having now worked through all of those suggestions, the staff believes that it would be helpful to put them in a broader context.

Very few of the comments relate to problems with the proposed law itself.

Most are complaints about existing law, with suggestions for substantive reform of that law. Whatever the merits of those suggestions, significant substantive reform of existing law is beyond the scope of the current study. As a practical matter, such reforms should be studied separately and included in more narrowly targeted legislative proposals.

Respectfully submitted,

Brian Hebert
Executive Secretary

Sun City Roseville Community Association, Inc.®

November 12, 2010

California Law Revision Commission
4000 Meadowfield Road, Room D-2
Palo Alto, CA 94303-4739

Sent via e-mail to: bhebert@clrc.ca.gov

Subject: Comments on the CLRC Tentative Recommendation for Statutory Clarification and Simplification of the Common Interest Development Law (Davis-Stirling)

Attention: Brian Hebert, CLRC Executive Director

As you are aware, Sun City Roseville Community Association has been following with interest the progress of the proposals of said Recommendation.

Our Governmental Affairs Committee has reviewed the copies of the various memos and Commission minutes it has received. We are forwarding to you as an attachment to this letter the comments they have prepared based on their review.

We continue to support your efforts in drafting this major undertaking and plan to do so as it works its way through the legislature.

Thank you for your consideration of our attached comments.

Sincerely,

for DeWolfe Emory

DeWolfe Emory, President
Sun City Roseville Community Association

Attached: Memo re CLRC Davis-Stirling Act Proposed Revision

EX 1

SUN CITY ROSEVILLE COMMUNITY ASSOCIATION
GOVERNMENTAL AFFAIRS COMMITTEE
November 9, 2010

To: Sun City Roseville Board of Directors
From: Governmental Affairs Committee

Re: CLRC Davis-Stirling Project

We have reviewed recent memos and minutes from the California Legislative Review Commission regarding the project to clarify and simplify the Davis-Stirling law and would like to submit the following comments to the Commission for its consideration.

Sections 4065 and 4070.

Our concern continues as to possible misinterpretation of voting requirements by lay members of a community. In the February Tentative Recommendation the discussion in two paragraphs (the Deletion of Declarant Powers and Assessment Increase) speaks of the problem with using a "quorum or vote of the members" when a separate interest is owned by more than one owner. The discussion concludes with: "The proposed law would correct this problem by basing the quorum on the voting power of those participating in the election, rather than the number of owners". The notes to several subsequent provisions echo the need to refer to voting power. We totally agree.

Apparently, the use of the term "voting power" has been rejected. While the original Section 4065 used the voting power terminology, it was changed in August to read: "...ratified by an affirmative vote of a majority of the votes entitled to be cast". We were unable to find any discussion of the issue, except for the comment in the August minutes: *A future memorandum will discuss the definition of "quorum" and the concept of "voting power."*

Although the new Section 4065 wording probably covers the situation adequately, it may be too subtle for the average homeowner compared to referencing voting power. (Also see comments on Section 5605 below)

In addition, the revised Section 4070 presented in MM10-48 seems garbled. Apparently the crossed out wording was unintentionally retained.

> 4070. If a provision of this Act requires that an action be approved by a majority of a quorum of the members, the action shall be approved or ratified by an affirmative vote of members representing more than a majority of the votes cast in an election at which a quorum is achieved. ~~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).~~

4230(d) Rather than referring to the voting power, the paragraph could be redrafted to state

> (d) The board may not amend the governing documents pursuant to this section without the approval of a majority of the members, pursuant to Section 4065, excluding members who own more than two separate interests.

Also, it is not clear that the owner of more than two separate interests can vote two separate interests but not more.

4265(a) Assuming the last sentence was changed as indicated in MM10-36, we assume that will include the reference to Section 4065:

> "the Legislature further finds .....the term of the declaration if approved by a majority of all members, pursuant to Section 4065.

4365(a) The revision in MM10-48 would be improved if the wording were changed:

> Members of an association ~~owning~~ representing five percent or more of the separate interests may call a special election to reverse a rule change.

(b) We wonder why the reference to "Article 4 (commencing with Section 5100) of Chapter 5" used at the end of the paragraph? Wouldn't the reference be more consistent and clearer to say: "pursuant to Section 5100, et seq."

(e) We wonder why this is needed? It is covered by Sections 4070 and 5140.

We recognize that three more memos are forthcoming before the December meeting, so the following items may have been addressed.

5115(a)(1) We suggest that you consider the following change to the third sentence which is consistent with the requirements in Placer County for absentee ballots and which our association uses for elections:

> ...In the upper left hand corner or on the reverse side of the second envelope, the voter shall sign the voter's name....

5140. It seems that this section on Voting Rights would be more useful if it preceded Section 4065 and as it would help to clarify the meaning of Sections 4065 and 4070. Alternatively, it is important enough to precede the details of the election process which begins at Section 5105. If neither of these changes is acceptable, perhaps the wording "pursuant to Section 5140(b)" could be added to Sections 4065 and 4070.

5605(a)(b)(c) We question why members who own more than two separate interests should be excluded from voting on assessment increases, particularly since it isn't in the current law. Surely such member is financially impacted for each of the owner interests, regardless of how many are owned. If that restriction is removed, the approval needed would be covered by 4065 and (c) can be deleted.

EMAIL FROM GEORGE STAROPOLI
(11/18/10)

Dear Mr. Hebert:

I am quite disappointed with the Commission's continued effort to replace the Davis-Stirling using a carbon copy with revisions dealing with the minutia of CID operations. And still refusing to recognize CIDs as de facto governments, much as Cuba is an unrecognized but de facto government. Furthermore, CLRC has seen fit to retain the placement of these special laws for the governance of communities under the Civil Code.

It appears that the special interest agenda, promoted by the national lobbying trade organization, Community Associations Institute (CAI), still dominates the Commission's thinking. Is the Commission aware of CAI's repudiation of the US Constitution when it wrote in its amicus brief to the NJ appellate court in Twin Rivers that, *"In the context of community associations, the unwise extension of constitutional rights to the use of private property by members . . . " ? Committee For A Better Twin Rivers v. Twin Rivers Homeowners Association (TRHA),* Docket No. C-121-00, 2004.

Davis-Stirling and the Commission's proposed rewrite continue to reflect the State's exercise of "coercive power", and "significant encouragement, either overt or covert" with regard to CIDs. The CID Laws portray the CID in a "symbiotic relationship" with the state, "entwined with governmental policies," and the state government is "entwined in [the CID's] management or control." Such conditions give easy rise to declaring the CID as a state actor. (See the summary of state action criteria as set forth by the US Supreme Court in *Brentwood Academy v. Tennessee Secondary School Athletic Ass'n,* 531 U.S. 288, 2001).

I cannot understand why the Commission continues to permit agreements by private parties to create local, private governments that are authoritarian and that deny homeowners their rights and freedoms to which they would otherwise be entitled. These "declarations" and CC&Rs are just that – devises to circumvent the application of constitutional protections and prohibitions with respect to local communities. The unsuspecting public is bound to these so-called agreements by virtue of taking hold on their deed sight unseen, without ever having to read, understand or sign these CC&Rs. The filing of these CC&Rs alone are necessary and sufficient to bind the homeowner, under servitude laws, and not contract law; where the legal-academic aristocrats offer advice that if a conflict exists between servitude law and constitutional law, servitudes law should prevail. (See Restatement Third, Property: Servitudes, § 3.1, comment h).

It is even more disturbing when existing California law, and similar laws in other states, permit the ability to attain the advertised benefits to the greater community of California and to the local CID community under municipality laws. In general, they are the special taxing district laws, and in California they are the District and Community Service District Codes (see Government Code, Title 6, §§ 58000 and 61000 et seq. below for the

relevant excerpts). If town hall democracy, local autonomy and the "voice of the community" are indeed the objectives of good government, then the District Code will meet these objectives, where the replacement of Davis-Stirling is nothing more than a top-down imposition on the local community of special laws for private organizations. The CID would be subject to the 14th Amendment as are all other public entities, and the laws of the land would indeed be equal for all people.

I outline the simple method for accomplishing the transformation of CIDs to taxing districts in Chapter 2 of ***Understanding the New America of HOA-Lands*** (attached for your edification and convenience). Chapter 3 explores ideal HOA constitutions and Chapter 4 is a lengthy discussion of the two forms of American political government: HOAs and public entities.

The Commission should cease and desist its current efforts to further promote the establishment of the second form of American political government, the CID, and return to supporting the principles of democratic government under the US and California Constitutions.

Respectfully,

George K. Staropoli
President
Citizens for Constitutional Local Government

References
California Government Code Title 6, Districts, Division 1, General, § 58000 et seq., and in particular Division 3, Community Service Districts, § 61000 et seq. as relevant.

§ 61001.
(a) The Legislature finds and declares all of the following:
(1) The differences among California's communities reflect the broad diversity of the state's population, geography, natural resources, history, and economy.

(b) The Legislature finds and declares that for many communities,community services districts may be any of the following:
(1) A permanent form of governance that can provide locally adequate levels of public facilities and services.
(3) A form of governance that can serve as an alternative to the incorporation of a new city.

(c) In enacting this division, it is the intent of the Legislature: (1) To continue a broad statutory authority for a class of limited-purpose special districts to provide a wide variety of public facilities and services.
(3) That residents, property owners, and public officials use the powers and procedures provided by the Community Services District Law to meet the diversity of the local conditions, circumstances, and resources.