Study H-855 August 20, 2009

First Supplement to Memorandum 2009-33

Statutory Clarification and Simplification of CID Law (Staff Draft)

Memorandum 2009-33 presents a staff draft of a proposed recodification of the Davis-Stirling Common Interest Development Act ("Davis-Stirling Act"). In that memorandum, the staff invited public comment on any technical problems that might exist in the draft.

The Commission has received four comment letters, which are attached in the Exhibit as follows:

Exhibit p.

- Kazuko Artus (8/17/09) 5
- Ravi Kapoor, Paramount (8/14/09) 1
- Ingrid M. Kollmann, Brownsville (8/18/09) 7
- Curtis C. Sproul, State Bar Real Property Law Section Working Group (8/20/09) 8

The staff appreciates the assistance provided by these commenters. Their comments are discussed below. All statutory references in this memorandum are to the Civil Code.

STATE BAR WORKING GROUP

Curtis C. Sproul writes on behalf of the State Bar Real Property Law Section Working Group that has been formed to review the proposed recodification of the Davis-Stirling Act. He indicates that the working group will have completed a careful review of the draft and will be able to provide detailed comments "well in advance" of the Commission's October 2009 meeting. See Exhibit p. 8. The staff has spoken with Mr. Sproul informally and is convinced that the working group will be able to meet that deadline and will provide the sort of detailed feedback that is required.

SUBSTANTIVE REFORMS PROPOSED

Ravi Kapoor writes to request that new substantive reforms be added to the proposed law, on the following topics: (1) mandatory penalties for board misconduct, (2) standardized document copying and mailing fees, (3) expanded annual reporting requirements, (4) new limits on client trust funds, (5) new limits on assessment increases, and (6) standardized proxy voting forms. See Exhibit pp. 1-4.

The staff will make note of the specifics of these suggestions for possible future study. However, as discussed in Memorandum 2009-33, such proposals are beyond the scope of the current project, especially at this late stage of the process.

TECHNICAL ISSUES

Proposed Section 4000. Short Title

The staff has received informal suggestions that the short title of the "Davis-Stirling Common Interest Development Act" be further shortened to the "Common Interest Development Act." The general idea is that the shorter title might be easier to remember and use. **The staff has no opinion on the merits of this suggestion.**

Proposed Section 4355. Application of Rulemaking Requirements

Kazuko Artus points out an error in the Comment to proposed Section 4355. The Comment incorrectly states that subdivision (a)(7) of that section is new. See Exhibit p. 5. **The staff regrets the error and will correct it in the next draft.**

Proposed Section 4360. Rulemaking Notice

Existing Section 1357.130 requires "written notice" to the members of an association when the board is proposing to adopt or change an operating rule.

Proposed Section 4360 provides that the notice is to be given under the procedure for delivery of "general notice." See proposed Section 4045 (general notice).

Ms. Artus maintains that this would constitute a substantive change. Further, she argues that it would be bad policy. "Such a change would be detrimental to member participation in the formulation of operating rules. It is imperative to

use individual notice for rule changes; impossible to get members' input in any proposed rule change by general notice." See Exhibit p. 5.

In the staff's view, the effect of the proposed change is not as significant as Ms. Artus suggests. Section 1357.130 does not require "individual" delivery of these notices (i.e., delivery by personal delivery, first class mail, or electronic delivery (proposed Section 4040)). The association currently has discretion to use a wide range of delivery methods when sending rulemaking notices. See Sections 1350.7, 1357.130(e). The range of permissible methods includes "individual" delivery methods, but it also includes "general" delivery methods (e.g., publication in a periodical, television broadcast).

The proposed law would preserve the existing range of options, with one additional option: a general notice could be posted in a public place that has been designated by the association for the posting of notices.

Posting of the notice could make it harder for some members to learn of a proposed rule change. However, the same risk exists under current law, if the association were to provide notice in a periodical or on television.

The proposed law would address that problem, by requiring that an association send notice by "individual" delivery methods to every member who requests such delivery. So even if the association posts its general rulemaking notices, any member who wishes to receive those notices by individual delivery would have that right (a right that does not exist under current law).

That would add flexibility for the association (by permitting posting of general notices), while improving access for the members (by permitting members to opt-in to receiving individually delivered rulemaking notices).

For that reason, the staff recommends against changing the substance of the proposed law on this issue. However, it might be appropriate to revise the Comment to proposed Section 4360 and add a staff note, to better highlight and explain these differences from existing law.

Proposed Section 4715. Pet guarantee

Ms. Artus questions the need for a special definition of the term "governing document" in proposed Section 4715 (which continues existing Section 1360.5). See Exhibit p. 5.

The staff agrees that it could be problematic to have a special definition that is very similar, but not identical, to a generally applicable definition of the same

term. That is the type of inconsistency that we would ordinarily clean up in a project of this sort.

However, Section 1360.5 is a special case. It is a politically sensitive provision that overrides pet restrictions in an association's governing documents, but only if the governing documents at issue were "entered into, amended, or otherwise modified on or after" January 1, 2001. Consequently, the definition of "governing documents" is critical to the operation of this provision, and could be dispositive on the issue of whether a particular association can or cannot prohibit pets. **The staff strongly recommends against making any change to the language of this provision, in order to avoid any concern that the proposed law would tip the balance one way or the other on this very contentious issue.**

Proposed Section 4930. Limitation on Meeting Content

Ingrid M. Kollmann points out, correctly, that the language used in proposed Section 4930(d) is somewhat confusing. That provision continues existing Section 1363.05(i)(4) without any change to the language at issue in this discussion. It reads as follows:

> (d) Notwithstanding subdivision (a), the board of directors may take action on any item of business not appearing on the agenda distributed pursuant to Section subdivision (a) of Section 4920 under any of the following conditions:
>
> (1) Upon a determination made by a majority of the board of directors present at the meeting that an emergency situation exists. An emergency situation exists if there are circumstances that could not have been reasonably foreseen by the board, that require immediate attention and possible action by the board, and that, of necessity, make it impracticable to provide notice.
>
> (2) *Upon a determination made by the board by a vote of two-thirds of the members present at the meeting, or, if less than two-thirds of total membership of the board is present at the meeting, by a unanimous vote of the members present,* that there is a need to take immediate action and that the need for action came to the attention of the board after the agenda was distributed pursuant to subdivision (a) of Section 4920.
>
> (3) The item appeared on an agenda that was distributed pursuant to subdivision (a) of Section 4920 for a prior meeting of the board of directors that occurred not more than 30 calendar days before the date that action is taken on the item and, at the prior meeting, action on the item was continued to the meeting at which the action is taken.

(Emphasis added).

Ms. Kollmann asks whether the italicized language is referring to board members, regular association members, or some combination of both. See Exhibit p. 7.

The staff believes that the provision is referring only to board members throughout. In other words, the determination is to be made by a vote of at least two-thirds of the board members, unless fewer than two-thirds of the board members are present, in which case all of the board members present must agree unanimously.

If the section were interpreted literally, it would make little sense. It would require a *board* determination, approved by two-thirds of the *members* present at the meeting, unless fewer than two-thirds of the *board* were present, in which case unanimous agreement of all *members* present would be required.

The staff recommends that the provision be revised to clarify its apparent meaning, as follows:

> (2) Upon a determination made by the board by a vote of two-thirds of the board members present at the meeting, or, if less than two-thirds of total membership of the board is present at the meeting, by a unanimous vote of the board members present, that there is a need to take immediate action and that the need for action came to the attention of the board after the agenda was distributed pursuant to subdivision (a) of Section 4920.

A note should also be added to flag that change and request public comment.

In reviewing proposed Section 4930(d), the staff also noticed an extraneous word that needs to be deleted, thus:

> (d) Notwithstanding subdivision (a), the board of directors may take action on any item of business not appearing on the agenda distributed pursuant to ~~Section~~ subdivision (a) of Section 4920 under any of the following conditions:

The staff regrets that drafting error and will correct it in the next version of the draft.

Proposed Section 5110. Election Inspector

Ms. Kollman also points out potentially confusing language in proposed Section 5110 (which continues existing Section 1363.03(c)).

Proposed Section 5110(b) provides:

> (b) For the purposes of this section, an independent third party includes, but is not limited to, a volunteer poll worker with the county registrar of voters, a licensee of the California Board of Accountancy, or a notary public. An independent third party may be a member of the association, but may not be a member of the board of directors *or a candidate for the board of directors* or related to a member of the board of directors *or a candidate for the board of directors.* An independent third party may not be 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.

(Emphasis added.) Ms. Kollman wonders whether the second use of the phrase "a candidate for the board of directors" is an inadvertent repetition. See Exhibit p. 7.

The staff sees how that sentence could be confusing, but believes that the second use of the phrase serves a necessary purpose. It is used to refer to a person who is "related to … a candidate for the board of directors." That meaning could be made clearer, if the provision were revised as follows:

> (b) For the purposes of this section, an independent third party includes, but is not limited to, a volunteer poll worker with the county registrar of voters, a licensee of the California Board of Accountancy, or a notary public. An independent third party may be a member of the association, but may not be a member of the board of directors or a candidate for the board of directors or <u>be</u> related to a member of the board of directors or <u>to</u> a candidate for the board of directors. An independent third party may not be 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.

The staff recommends that the proposed law include that clarifying revision, along with a note flagging the change and asking for public comment on its merits.

"Reserve" Terminology

Kazuko Artus correctly points out that a wide variety of terms are used in the provisions relating to reserve funds and reserve funding. She sees room for improvement of that terminology. See Exhibit pp. 5-6.

The staff agrees. More broadly, it would be helpful to do a general review of the accounting terminology used in the Davis-Stirling Act, to make it more uniform, understandable, and consistent with prevailing usage in the accounting profession. The staff had started such a review, but it was derailed by the decision to follow a conservative drafting approach in this iteration of the proposed law. **The Commission should eventually conduct a general review of the accounting terminology used in the Davis-Stirling Act, but not in connection with the current proposal.**

Respectfully submitted,

Brian Hebert
Executive Secretary

EMAIL FROM RAVI KAPOOR
(8/14/09)

August 14th, 2009
Honorable Mr. Brian Herbert
Re TR -H855
California Law Revision Commission,
4000 Middlefield Rd room D-1
Palo Alto, CA 94303

Respected Mr. Brian Herbert,
Re TR _H855

As an affected Homeowner, I am writing this note in my personal capacity in response to H-855 simplified version dated 08/10/2009 and would like to congratulate CLRC for working in the improvement of CID laws and all out efforts are being made to simplify Davis-Sterling act to the extent possible. However I strongly feel that in my opinion with due respect is not in the best interest of Homeowners, The Concerned People based upon the proposed final recommendations due for hearing on 08/28/2009 unless the subject is once again reviewed once again as mentioned.

However it is strongly felt that the under noted comments are submitted for your sympathetic review and active consideration.

Sir you shall agree that you are doing a Herculean task for making CID laws more transparent as part of fiduciary duty to all concerned directly and indirectly involved in such living but it is felt that there is ample room for the improvement.

Moreover the existing laws have not been able to address basic issues viz elections, reserves, assessments regular and special, liens etc to name few and no meaningful mandated penalty for associations for non-compliance for one reason or other. The call of the time is COMPLAINCE AND ENFORCEMENT FOR THE STATUES for which humble request is made to Honorable lawmakers to have corrective necessary steps in the interest of the Concerned People and PROTECT OUR HOMES AND EQUITY THAT VESTED INTERESTS HAVE MADE NON-PROFIT CORP TO ONLY FOR PROFIT ENTITIES WITHOUT HAVING ANY VESTED PERSONAL INTEREST THIRD PARTIES AS I FEEL.

Sir you may also agree that such opportunity shall not come time and again to re-do again. It lies with CLRC to make it a success and otherwise. Reforms shall remain in abeyance indefinately as I feel.

Proposed Recommendations to the California legislature on a myriad of common interest development-related legislation, as I feel may be considered to include MEANINGFUL AND EASILY ENFORCEABLE PENALTIES against erring boards if

any; fines and criminal liability statutes over agents, third party vendors, management companies and their personnel; titleholder protections against association, boards of directors, attorneys and agents of the association, and their use of owner personal information and identifying factors; financial Code statutes to prohibit any association from allowing or waiving the commingling of association bank accounts and assets of Homeowner if any. In case such cases occur, these may be dealt severely by the State to avoid any reoccurrences in the interest of the Concerned People.

It is strongly felt that as a caution to all concerned in case such cases arise if any if deem fit that in case fraud, theft or embezzlement on part of the concerned, Attorney -General, District Attorney /FBI/IRS-FTB/INSURANCE COMMISIONERS shall not hesitate in filing criminal actions if needed in the interest of communities.

In the absence of no cost-effective way for the affected owner to enforce a penalty against the concerned that acts unlawfully if any with the protection against liability insurance shield. And in view of so many complexities and restrictions in CID living, the very purpose of such living has been lost. For the growth of state and economy, CID living plays an important role as it has great impact on the State infrastructure and cannot be ignored as I feel.

Honorable Mr. Herbert may also consider that existing practices place automatic contingency on the purchase and sales directly or indirectly with extra financial burden in present real estate market and may have impact on living for one reason or other. I also feel it also has impact on the growth and economy of the state.

As an affected homeowner and to the best of my ability it is proposed to incorporate following changes to the recommendations if deem fit

· § Prospective managing agent

In addition to what has been stated

To provide schedule of rates for copying of documents/mailing cost per first class or hand-delivery viz purchase orders of vendors, minutes of meeting, resolutions copy for foreclosure/lien signed copies and not computer print -out copies. No retrieving charges/storage charges shall be applicable with the ANNUAL REPORT PACKAGE.

· § ANNUAL FINANCIAL STATEMENT

In addition to what has been mentioned to incorporate all spending towards /bad debts/reserve fund viz cost of replaced modification /date of installation of equipment, name and address of vendor with total cost and customer service reference for future reference. Moreover in case bad-debt amount is more than 5% of the total assessment, necessary approval may be taken from members in quorum.

May also mention if any Director is interested directly or indirectly in such vendor in the explanatory statement/notes as per existing practices.

· § MEMBER HAND BOOK

In addition to what has been stated it may be made mandatory for BOD to submit annual report duly signed for what has been done, what future jobs to be undertaken as form for budgeted expenses and how the finances shall be met with any other suggestions if any. Forming part of annual package.

· § TRUST FUND

In addition to what has been stated to incorporate if funds have used for temporary transfer of fund and for what purpose and how this have replenished. Break-up details as reserve added, interest accrued with other relevant details as necessary as part of annual package.Trust fund s/Reserve [funds] need to be handled by two directors in my [opinion] may please be regulated.

· §RESERVE FUND

In addition to what has been mentioned, reserve study must incorporate details of equipment history date of installation, cost actual at the time of installation and expected future cost with relevant details, which are considered necessary.

This information is very necessary from IRS/FTB viewpoint towards establishing life expectancies and life of equipment. This shall also help in finding out early failure rate if any and future hidden unexpected costs.

· § ASSESSMENT

Present law for 20 % increase regular assessment and 5% increase without approval may be amended to once in THREE-YEAR TIME. In case additional assessment is needed may be need to be approved by the members accordingly.

However under no circumstances increase is affected without justification and comments from Board of Directors per resolution duly signed per good practices and to be used for the purpose it has been assessed. In my opinion it is being done as a blanket provision of the existing laws.

· § ELECTION: PROXY FORM

In addition to what has been stated,

It is strongly felt that specimen prototype proxy form as per good practice may be documented per corporation code to be followed by all concerned to improve clarity and substance viz proxy vote, no vote and only for quorum suitably drafted AS A PART OF SIMLIFICATION AND CLARITY in addition of explanatory notes as per respective corporation code. In short efforts shall be made to ensure transparent Financial statement as per best practices.

Honorable Mr. Herbert may also consider that existing practices place automatic contingency on the purchase and sales directly or indirectly with extra financial burden in present real estate market and may have impact on living for one reason or other. I also feel it also has impact on the growth and economy of the state.

Under the circumstances, it is strongly felt that if deem fit corrective steps may be taken at the earliest to ratify the existing laws for COMPLIANCE AND ENFORCEMENT of such laws with mandated penalties if needed along with state regulating agency such as FCC/FTC/Attorney General office with extra powers etc to be read in context.

As stated in the recommendations that the proposed law would authorize a civil action to enforce any provisions of the amended law WITH THE REQUEST TO REVIEW INCREASE OF PENALTY FROM $500.00 TO $1000.00 WHEREVER APPLICABLE.

In my opinion with due respect the subject may be sympathetically reviewed and as a token of gesture may kindly be put forth to the Honorable review committees if deem fit in the interest of all concerned.

Needless to mention that the issues are so complex that it is very difficult to refer in few lines. However I am sure your efforts shall certainly MAKE THE DIFFERENCE.

It may also be added that in view of complex nature of issues and to avoid reoccurrence of the present state of affairs, it is strongly suggested to have an exclusive task force /study group to look into the issues to have its scope and references in co-ordination with the State Govt and its agencies and may come forward with the recommendations in the interest of all concerned if deem fit. I am of the opinion the subject needs extensive study to have reforms in the various aspects of the Davis –Sterling Act from all concerned

With kindest regards,

Truly yours,

(Ravi Kapoor)

EMAIL FROM KAZUKO ARTUS
(8/17/09)

Brian,

This is my quick reaction to your "principal question." You can take this e-mail either as an informal communication to you or as a public comment, as it suits your schedule.

Comment to Proposed Section 4355. The clause "except that subdivision (a)(7) is new" is incorrect. Proposed subd. (a)(7) is exactly the same as subd. (a)(7) of Sec. 1357.120. Proposed Sec. 4355 is exactly the same except for the substitution of "Sections 4360 and 4365" for "Sections 1357.130 and 1357.140."

Proposed Section 4360(a). The substitution of "general notice (Section 4045)" for "written notice" in Section 1357.130 is a material substantive change. Such a change would be detrimental to member participation in the formulation of operating rules. It is imperative to use individual notice for rule changes; impossible to get members' input in any proposed rule change by general notice. Some operating rules set forth a complex procedural scheme (the election procedures of my association consist of 57 paragraphs). There is no way any one can read the text of a proposed rule change if the notice is posted in a location accessible to all members (Proposed Section 4045(a)(3)). I believe that a proposal to change "written notice" to "general notice" constitutes a serious technical error from a policy viewpoint.

Proposed Section 4715(d). Why is it necessary to deviate from the definition in proposed Section 4150 of "governing documents" for the purposes of restricting associations' interference with keeping pets in separate interests? I do not find anything in proposed Section 4715(d) which is not enumerated in proposed Section 4150. Am I overlooking something?

Reserve. Proposed sections relating to the associations' reporting and financial management are definitely better organized than their counterparts in the present Davis-Stirling Act. Congratulations! But they are still difficult to follow. This problem, inherited from the present Davis-Stirling Act, seems to be largely attributable to the absence of the definition of the word "reserve" and the use of many terms (most of them undefined) which contain the word "reserve": "cash reserves," "reserve," "reserve account," "reserve accounts," "reserve account balances," "reserve account funds," "reserve account requirements," "reserve amount," "reserve calculation," "reserve fund," "reserve fund cash balance," "reserve funding," "reserve funding plan," "reserve funding study," "reserve funds" (I figure from the context that this is not the plural of "reserve fund"), "reserve plan," "reserve planning," "reserve reports," "reserve study," "reserve study plan" (used only once in proposed Section 5300(b)(3), probably an inherited typographical error), "reserve study report" (also used only once in proposed Section 5570(b)(2)), and "reserves" (I am not sure whether this is merely the plural of

"reserve"). What is behind all this is the Legislature's desire that CID associations provide for the wears and tears (and probably obsolescence) of "major components," isn't it? I plan to write again (perhaps in commenting on the forthcoming draft tentative recommendation) after reading a few more times the proposed sections relating to reporting requirements and financial management and their existing counterparts.

Regards,
Kazuko

EMAIL FROM INGRID M. KOLLMANN
(8/18/09)

Mr. B. Hebert
California Law Revision Commission
3200 5th Ave
Sacramento, CA 95817

Dear Mr. B. Hebert:

As requested in the PDFile (your August 10 email), herewith please find my (minor technical errors?) comments for consideration.

Trust you will find this input useful.

Sincerely,

Ingrid M. Kollmann
Aero Pines Association
Brownsville, CA 95919-0359

Regarding § 4930 (REVISED) below, the language is very confusing. Are we talking about the Members of the Board, the HOA Members, or both?

§ 4930 (REVISED). Limitation on meeting content, Page 51 (continued)

(2) Upon a determination made by the board by a vote of <u>two-thirds of the members present at the meeting, or, if less than two-thirds of total membership of the board is present at the meeting, by a unanimous vote of the members present</u>, that there is a need to take immediate action and that the need for action came to the attention of the board after the agenda was distributed pursuant to subdivision (a) of Section 4920.

Regarding § 5110 (UNCHANGED) below, it appears that "a candidate for the board of directors" is listed twice.

§ 5110 (UNCHANGED). Election inspector

5110. (a) The association shall select an independent third party or parties as an inspector of election. The number of inspectors of election shall be one or three.

(b) For the purposes of this section, an independent third party includes, but is not limited to, a volunteer poll worker with the county registrar of voters, a licensee of the California Board of Accountancy, or a notary public. An independent third party may be a member of the association, but may not be a member of the board of directors or <u>a candidate for the board of directors</u> or related to a member of the board of directors <u>or a candidate for the board of directors</u>.

SPROUL
TROST
REAL ESTATE & CORPORATE
ATTORNEYS AT LAW
A LIMITED LIABILITY PARTNERSHIP

Curtis C. Sproul
(916) 783-6262

August 19, 2009

Brian Hebert
Executive Secretary
California Law Revision Commission
3200 5th Avenue
Sacramento, CA 95817

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

Re: Preliminary Comments of State Bar Real Property Law Section Working Group on the revised draft of a proposed recodification of the Davis-Stirling Common Interest Development Act.

Dear Brian:

On August 10, 2009 your staff published a revised proposed recodification of the Davis-Stirling Common Interest Development Act. This revised proposal has now been preliminarily reviewed by all members of the Working Group that was formed as an adhoc subcommittee of the Real Property Law Section of the State Bar of California. As you know, this Working Group has undertaken the task to review and comment on this project of the California Law Revision Commission.

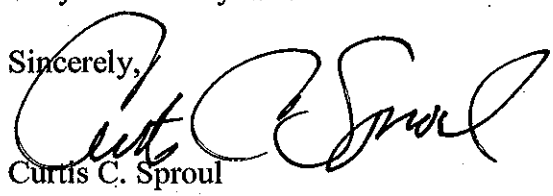
As I committed in a recent call to you, the Working Group members participated today in an extended telephone conference call. Because the next meeting of the Commission is scheduled for Wednesday of next week, it was the consensus of the Working Group that we have insufficient time to offer detailed comments prior to that meeting. However, we do intend to provide the Commission Staff with those comments and recommendations well in advance of the next meeting of the Commission in October at which you intend to recommend the adoption of the new draft as a "draft tentative recommendation."

The Working Group finds the new proposed draft recodification to be a substantial improvement over the prior draft proposal. We particularly support the general organization of the substantive law provisions of the Act in the new draft and the return, in many instances, to a verbatim presentation of the current text of the Act. The Staff Notes following each section of the draft will also be of considerable assistance in facilitating the Working Group's review.

Nevertheless, most, if not all of the members of the Working Group, feel that there are still some organizational issues to be addressed. As well there will likely be several technical comments that need to be worked through. To expedite our review and finalization of those comments prior to the October meeting, individual members of the Working Group have each committed to taking the lead in reviewing at least one of the nine Chapters that constitute the draft proposal for a reorganized Act. All members have committed to review and comment on the entire draft, but each Chapter will have a particular person with principal responsibility.

We wish to thank the Commission Staff for the considerable time and effort that was expended during the past several months to generate this new draft proposal and we look forward to working closely with the staff to provide constructive comments that we believe will result in a final proposal that will improve the organization, clarity, and accessibility of this important body of statutory law.

Sincerely,



Curtis C. Sproul
On behalf of the Common Interest Development Legislative Advisory Committee,
A working group of the State Bar Real Property Law Section, Subsection on
Common Interest Developments

cc: Scott Rogers, Chairman, Executive Committee of the
State Bar Real Property Law Section
Pam Wilson, State Bar Director of Sections
Paul Dubrasich
Marianne Adriaticio
Mary Howell
David Van Atta
Katie Jacobsen
Sandra Bonato
Gary Kessler