Study H-855 December 1, 2010

Memorandum 2010-58

Common Interest Development: Statutory Clarification and Simplification of CID Law (Comments on Finance 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 finance-related provisions of the proposed law.

The Comments discussed in this memorandum are set out in the Exhibit to Memorandum 2010-36.

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.

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

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.

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."

GENERAL RECOMMENDATIONS

As with previous memoranda in this study, most of the comments that we have received express concerns about existing law, rather than about any change that the proposed law would make. **As a general matter, the staff recommends against making significant substantive changes to existing law in the current study.**

We have also received a large number of comments proposing technical or clarifying changes to the language of existing law. As discussed above, the Commission has adopted a conservative approach to drafting the proposed law. Minor stylistic and technical changes to existing language will generally not be made, unless it is clear that they are necessary to cure a plain defect. **For that reason, the staff recommends against making many of the suggested language changes discussed below.**

These general recommendations seem even more appropriate when applied to the finance provisions of the Davis-Stirling Act. Those provisions are highly technical and controversial. Any change to those provisions could have a real or perceived financial impact that could provoke strong opposition. What's more, the Commission has already expressed its intention to conduct a comprehensive review of the accounting and finance provisions of the Davis-Stirling Act.

In light of the number, importance, and thoughtfulness of the comments that we have received on the finance provisions, the staff strongly recommends that the separate study of accounting and finance matters be

given a high priority. Resources permitting, it could perhaps be started in 2011. If not, serious consideration should be given to starting the study in 2012.

Substantive Changes to Existing Law

The Comments listed below raise substantive concerns about existing law that are too significant or potentially controversial (or both) for inclusion in the proposed law:

- Proposed Section 5500 should be revised to establish substantive standards to govern the board's "review" of accounting information. See Memorandum 2010-36, Exhibit p. 60.
- Proposed Section 5500 should be revised to require that all the tasks described in the section be performed quarterly (the duty described in subdivision (d) does not specify the frequency with which it must be performed). See Memorandum 2010-36, Exhibit p. 216.
- Proposed Sections 5510 and 5515 should be revised to clarify the effect of the provision's restrictions on the use of "reserve funds." See Memorandum 2010-36, Exhibit pp. 167-68.
- Proposed Section 5550 should be revised to require inspection of all major components of the common area, not just those that are "visible" and "accessible." See Memorandum 2010-36, Exhibit pp. 39-41.
- Proposed Section 5570(a)(3) should be deleted or significantly restructured. See Memorandum 2010-36, Exhibit p. 169.
- Proposed Section 5600 should be revised to require a strict correlation between assessments and association costs; any surplus should be refunded to the members. See Memorandum 2010-36, Exhibit p. 61.
- Proposed Section 5605 should be revised to specify the consequences when an association raises assessments in contravention of the requirements of the section — the law should permit member ratification of an illegal increase. Failing that, the illegally collected amount should be refunded. See Memorandum 2010-36, Exhibit p. 60.
- Proposed Section 5605(a) should be revised to soften the rule requiring member approval of an assessment increase if the association did not distribute the annual budget on time. The association should be able to cure the defect and then proceed with the assessment increase. See Memorandum 2010-36, Exhibit p. 71.
- Proposed Section 5605 should be revised to make clear that it has no application to fees for optional services. See Memorandum 2010-36, Exhibit p. 71.

- Proposed Section 5605 should be revised to further limit the board's discretion to increase assessments without member approval. Such increases should be limited to the increase in the Consumer Price Index. See Memorandum 2010-36, Exhibit pp. 73-75.
- Proposed Section 5610 should be revised to provide that the emergency "assessment increase" exception also applies to an emergency special assessment. See Memorandum 2010-36, Exhibit p. 216.
- Proposed Section 5620 should be revised to expand the scope of the exception for "essential services." See Memorandum 2010-36, Exhibit p. 217.
- Proposed Section 5625, permitting some associations to set assessments based on assessed property tax values, should be reevaluated. See Memorandum 2010-36, Exhibit p. 71.
- Proposed Section 5655 should be revised to limit the application of the "principal first" payment application rule — that rule should not apply if payments are delinquent or there is a payment plan in place. See Memorandum 2010-36, Exhibit p. 217.
- Proposed Section 5665 should be revised to permit the board in a large association to delegate its duty to meet with members to discuss payment plans. See Memorandum 2010-36, Exhibit p. 71.
- Proposed Section 5665 is unworkable as drafted. It should be deleted or restructured. See Memorandum 2010-36, Exhibit pp. 175, 217.
- Proposed Section 5670 should be deleted as redundant (it arguably duplicates proposed Section 5660(e)). See Memorandum 2010-36, Exhibit pp. 177-78.
- Proposed Sections 5673 and 5705 should be revised to clarify that "a majority vote of the directors" means a majority of those present at a meeting at which a quorum has been achieved, not a majority of the full membership of the board. See Memorandum 2010-36, Exhibit p. 178.
- Proposed Section 5720 should be revised to indicate whether the $1,800 minimum amount for foreclosure on assessment debt is "reset" if the debt is partially paid off, bringing the principal below $1,800. See Memorandum 2010-36, Exhibit p. 182.
- Proposed Section 5720 should be revised to indicate whether the exclusion of "accelerated assessments" in calculating assessment debt, applies to both regular and special assessments. See Memorandum 2010-36, Exhibit p. 182.
- Proposed Section 5720(b)(1)(B) should be revised to remove the court's discretion on whether to include post-filing assessments in a judgment. See Memorandum 2010-36, Exhibit p. 183.

- Proposed Section 5720(b)(2) should be revised to reflect other proposed changes to the section. See Memorandum 2010-36, Exhibit p. 183.
- Proposed Section 5275 should be revised to add an affirmative statement of the vicarious liability of a member for damage to the common area by specified associates of the member. See Memorandum 2010-36, Exhibit p. 184.
- Proposed Section 5275 should be revised to make clear that a member may be liable for damage to the common area, even if the association decides against repairing the damage. See Memorandum 2010-36, Exhibit p. 184.
- Proposed Section 5800 should be revised so that the director and officer liability limitations provided in the section are not restricted to an *exclusively* residential CID. See Memorandum 2010-36, Exhibit pp. 72, 83, 186-87.
- Proposed Section 5800 should be revised so that the director and officer liability limitations provided in the section are not restricted to directors and officers who own fewer than three separate interests in the CID. See Memorandum 2010-36, Exhibit p. 187.
- Proposed Section 5800 should be revised to specify the meaning of "good faith." See Memorandum 2010-36, Exhibit p. 83.
- Code of Civil Procedure Section 425.15 should be revised to extend its protections to a volunteer officer or director in a CID. See Memorandum 2010-36, Exhibit p. 187.
- The law should be revised to require that owners provide proof of homeowners insurance to the association. See Memorandum 2010-36, Exhibit p. 47.
- The law should be revised to clarify the extent to which an association may insure its directors and officers. See Memorandum 2010-36, Exhibit p. 83.

The staff recommends against addressing those issues in the proposed law. They should be considered as part of a comprehensive study of the finance provisions of the Davis-Stirling Act.

Technical Revisions to Existing Language

The comments listed below suggest technical changes to existing language that are not consistent with the conservative drafting approach taken in the current study:

- Proposed Section 5515(d) should be revised to clarify the meaning of "supported by documentation," in a provision requiring such support for an exception to ordinary reserve fund use restrictions. See Memorandum 2010-36, Exhibit p. 168.

- Proposed Section 5550(b)(1) should be revised to replace "less than 30 years" with "30 years or less," to be consistent with similar usage elsewhere in the Act. See Memorandum 2010-36, Exhibit p. 216.
- Proposed Section 5560 and 5615 should be revised to better reflect the differences between regular and special assessments. See Memorandum 2010-36, Exhibit p. 168, 174.
- Proposed Section 5565(b)(1)-(2) should be revised to specify the time frame for the estimates required in those provisions. See Memorandum 2010-36, Exhibit p. 70.
- Proposed Section 5565(c) should be revised to state its meaning more clearly. See Memorandum 2010-36, Exhibit pp. 168-69.
- Proposed Section 5580 should be revised to resolve the ambiguities discussed in the staff note following that section. See Memorandum 2010-36, Exhibit p. 169.
- Proposed Section 5605(a) should be revised to delete the word "annual." See Memorandum 2010-36, Exhibit p. 172.
- Proposed Section 5605(b) should be revised to clarify the meaning of the "famous double negative." See Memorandum 2010-36, Exhibit pp. 70, 73-80, 172-73.
- The term "levy" should be defined. See Memorandum 2010-36, Exhibit p. 71.
- A new section should be added, preceding proposed Section 5650, that would include part of the substance of proposed Section 5650(a) along with a paraphrase of the authority to lien provided in proposed Section 5675(a). See Memorandum 2010-36, Exhibit p. 175.
- Proposed Section 5650(b) should be revised to make clear that assessments are only delinquent if not paid in the specified time period. See Memorandum 2010-36, Exhibit p. 217.
- Proposed Section 5660 should be revised to paraphrase part of the substance of a referenced provision. See Memorandum 2010-36, Exhibit p. 176.
- Proposed Section 5665 should be revised to clarify its meaning. See Memorandum 2010-36, Exhibit p. 177.
- Proposed Section 5673 should perhaps be revised to delete the application date provision. See Memorandum 2010-36, Exhibit p. 178.
- Proposed Section 5675 should be revised to improve its clarity. See Memorandum 2010-36, Exhibit pp. 178-79.
- Proposed Section 5680 should be revised to improve its clarity. See Memorandum 2010-36, Exhibit p. 179.

- Proposed Section 5685 should be revised to more clearly specify the type of "error" that triggers the fee shifting provided in the section. See Memorandum 2010-36, Exhibit p. 217.
- Proposed Section 5705 should be revised to improve its clarity. See Memorandum 2010-36, Exhibit p. 180.
- Proposed Section 5715 should be revised to specify who may exercise the right of redemption. See Memorandum 2010-36, Exhibit p. 71.
- Proposed Section 5720 should be revised to replace references to "recording a lien" with references to "recording a notice of delinquent assessment." See Memorandum 2010-36, Exhibit p. 182.
- Proposed Section 5720(b)(1)(A) should be revised to replace "complaint" with "claim." See Memorandum 2010-36, Exhibit p. 182.
- Proposed Section 5730 should be revised to substantially recast the statutory form notice into "plain English" and improve its accuracy. See Memorandum 2010-36, Exhibit pp. 184-85.
- Proposed Section 5740 should be moved from the end of its article, to the beginning of the article. See Memorandum 2010-36, Exhibit p. 186.
- The terms "assessment debt" and "notice of delinquent assessment" should be defined and the definitions used in place of similar but varying terminology throughout the assessment provisions. See Memorandum 2010-36, Exhibit p. 171.

The staff recommends against making those revisions in the proposed law. They should be considered as part of a comprehensive study of the finance provisions of the Davis-Stirling Act.

The comments listed below suggest technical revisions that are either necessary to correct a plain defect or consistent with the Commission's goal of promoting terminological uniformity:

- Proposed Section 5655(c) should be revised to note that the address for payment of assessments must be included in the annual policy statement (pursuant to proposed Section 5310(a)(11)). See Memorandum 2010-36, Exhibit p. 176.
- Proposed Section 5565(b)(3) should be revised to correct a grammatical problem. See Memorandum 2010-36, Exhibit p. 168.
- Proposed Sections 5600(a), 5620, and 5925 should be revised to replace "this title" with "this Act." See Memorandum 2010-36, Exhibit p. 172.
- The Comment to proposed Section 5600(b) should be revised to state it continues Section 1366.1 "without change." See Memorandum 2010-36, Exhibit p. 61.

- The Comment to proposed Section 5605(a) should be revised to correct a cross-reference error. See Memorandum 2010-36, Exhibit p. 172.
- Proposed Section 5658 should be revised to provide a reference to the "small claims court," to ease understanding of a statutory reference to the small claims division of the superior court. See Memorandum 2010-36, Exhibit p. 176.
- The heading to proposed Section 5725 should be revised to better match its content. See Memorandum 2010-36, Exhibit p. 184.
- Proposed Section 5730 should be revised to replace "he or she" with "the owner." See Memorandum 2010-36, Exhibit p. 72.

The staff recommends that those changes be made.

RESERVE FUND USE

Proposed Section 5510(b) would continue the substance of existing Section 1365.5(c)(1), thus:

> The board shall not expend funds designated as reserve funds for any purpose other than the repair, restoration, replacement, or maintenance of, or litigation involving the repair, restoration, replacement, or maintenance of, major components that the association is obligated to repair, restore, replace, or maintain and for which the reserve fund was established.

Proposed Section 5520 would continue the substance of existing Section 1365.5(d), thus:

> 5520. (a) When the decision is made to use reserve funds or to temporarily transfer moneys from the reserve fund to pay for litigation, the association shall provide general notice pursuant to Section 4045 of that decision, and of the availability of an accounting of those expenses.
>
> (b) 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.

A working group of the California State Bar Real Property Law Section ("RPLS Working Group") believes that the separation of those provisions could lead to misunderstanding. Under existing law, it seems clear that the reference to "litigation" in proposed Section 5520 refers to the litigation referenced in proposed Section 5510(b) (i.e., "litigation involving the repair, restoration,

replacement, or maintenance of, major components…"), rather than to litigation generally. When the two provisions are separated, as in the proposed law, the connected meaning of "litigation" in the two provisions could be obscured. See Memorandum 2010-36, Exhibit p. 168.

The staff recommends that the proposed law be revised to avoid creating any new potential for misunderstanding. The RPLS Working Group suggests adding a cross-reference in proposed Section 5520, along these lines:

> When the decision is made to use reserve funds or to temporarily transfer moneys from the reserve fund to pay for litigation pursuant to subdivision (b) of Section 5510, the association shall provide general notice pursuant to Section 4045 of that decision, and of the availability of an accounting of those expenses.

That seems like an appropriate solution. **The staff recommends that the change be made.**

RESERVE PLANNING

Reserve Funding Plan

Proposed Section 5560 would continue provisions specifying the content of an association's "reserve funding plan."

Subdivision (a) of the proposed Section would provide:

> The reserve funding plan required by Section 5550 shall include a schedule of the date and amount of any change in regular or special assessments that would be needed to sufficiently fund the reserve funding plan.

Duncan McPherson wonders whether that provision would "now require full funding of reserves?" If not, he questions whether it serves any good purpose. See Memorandum 2010-36, Exhibit p. 70.

The language is drawn, nearly verbatim, from the second sentence of existing Section 1365.5(e)(5), which reads:

> The plan shall include a schedule of the date and amount of any change in regular or special assessments that would be needed to sufficiently fund the reserve funding plan.

Consequently, any ambiguity or questionable purpose relating to that provision already exists and would not be created by the proposed law. For what it is worth, the staff has always read this provision as requiring a hypothetical

statement, to inform members of their reserve situation, without actually mandating full funding of reserves. **The staff recommends against making any change to the provision.**

ORGANIZATION OF ASSESSMENT PROVISIONS

Under the proposed law, the assessment provisions are organized as articles within the chapter on "Finances" — "Article 4. Assessment Setting," "Article 5. Assessment Payment and Delinquency," and "Article 6. Assessment Collection."

The RPLS Working Group believes that organizational scheme could be improved. The assessment provisions should either be moved to the front of the "Finances" chapter, or organized as a separate chapter. This would better reflect the importance of those provisions and would make them easier to find. See Memorandum 2010-36, Exhibit pp. 169-70.

The staff believes that this is a good idea. The assessment-related provisions are sufficiently distinct from the accounting and reserve funding provisions that a separate chapter would probably be a helpful organizational improvement. This could be accomplished easily, by inserting a chapter heading before proposed Section 5600, entitled "Assessments and Assessment Collection," as the RPLS Working Group suggests. The assessment related articles and the following chapters could be renumbered accordingly, thus:

> Chapter 7. Assessments and Assessment Collection
> Article ~~4~~ 1. Assessment Setting
> Article ~~5~~ 2. Assessment Payment and Delinquency
> Article ~~6~~ 3. Assessment Collection
> Chapter ~~7~~ 8. Insurance and Liability
> Chapter ~~8~~ 9. Dispute Resolution and Enforcement
> Chapter ~~9~~ 10. Construction Defect Litigation

The staff recommends that those changes be made.

On a related point, the RPLS Working Group suggests that Article 4 be renamed as follows: "~~Assessment Setting~~ Establishment and Imposition of Assessments." See Memorandum 2010-36, Exhibit p. 172. **The staff is inclined toward making that change.** It is not *essential* that the change be made, but the proposed language might be slightly more informative as to the contents of the article. Because the heading would be new, and a heading has no substantive effect, there is no concern about adhering to the proposed language verbatim.

Proposed Section 5605 would, with minor changes, continue existing restrictions on an association's discretion to raise regular assessments or impose special assessments:

> 5605. (a) Annual increases in regular assessments for any fiscal year shall not be imposed unless the board has complied with Section 5300 with respect to that fiscal year, or has obtained the approval of a majority of a quorum of members, pursuant to Section 4070, at a member meeting or election.
>
> (b) Notwithstanding more restrictive limitations placed on the board by the governing documents, the board may not impose a regular assessment that is more than 20 percent greater than the regular assessment for the association's preceding fiscal year or impose special assessments which in the aggregate exceed 5 percent of the budgeted gross expenses of the association for that fiscal year without the approval of a majority of a quorum of members, pursuant to Section 4070, at a member meeting or election.
>
> (c) For the purposes of this section, "quorum" means members representing more than 50 percent of the voting power of the association.

Some comments on this provision are discussed above, under "General Recommendations." The remainder are discussed below.

Budget Distribution

Existing law requires member approval of a regular assessment increase if the association has not complied with Section 1365(a). Proposed Section 5605(a) would broaden that rule slightly. The proposed broadening would be a substantive change in the law. A note following proposed Section 5605(a) explains:

> Existing Section 1366(a) requires member approval of an assessment increase if the board has not complied with Section 1365(a) for the fiscal year. Section 1365(a) requires the distribution of the annual pro forma budget.
>
> In proposed Section 5605, the reporting requirement is broadened slightly, to simplify its application. It would require member approval of an assessment increase if the board does not distribute the "annual budget report" pursuant to proposed Section 5300. That report includes all of the elements of the existing pro forma budget, plus two related items that are currently not within the scope of [Section 1365(a)]: the reserve funding plan distributed

pursuant to Section 1366(b) and the insurance coverage notice distributed pursuant to Section 1366(f).

The RPLS Working Group opposes the change, objecting to the creation of any new requirements that could impede an association's ability to raise assessments as needed. See Memorandum 2010-36, Exhibit p. 170.

The Commission's approach in preparing the proposed law has been to omit controversial substantive changes. The Comments from the RPLS Working Group suggest that this change is too controversial to be included in the proposed law. **The staff recommends that the following revision be made to preserve the effect of existing law:**

> 5605. (a) Annual increases in regular assessments for any fiscal year shall not be imposed unless the board has complied with paragraphs (1), (2), (4), (5), (6), (7) and (8) of subdivision (b) of Section 5300 with respect to that fiscal year, or has obtained the approval of a majority of a quorum of members, pursuant to Section 4070, at a member meeting or election.
>
> …

Obviously, that language would be more awkward. But it would avoid the substantive broadening that is opposed by the RPLS Working Group.

Member Meeting

The RPLS Working Group objects to inclusion of the words "member meeting" in proposed Section 5605(a)-(b). They described those as additions to existing law that would have problematic substantive effect (because the decisions are governed by Section 1363.03 and therefore "are not, and cannot be made" at a member meeting). See Memorandum 2010-36, Exhibit pp. 172-73.

The staff does not understand the concern, for two reasons:

First, the proposed law would not add the references to making the decision at a meeting. Those references already exist in Section 1366. The only change made in the proposed law is to insert the word "member" before "meeting." The staff believes that to be a technical clarifying change, and not a substantive one.

More significantly, the staff does not believe that Section 1363.03 precludes conducting a secret ballot election at a member meeting. It is true that secret written ballots must be mailed to members, but nothing in Section 1363.03 requires that the election be conducted entirely by mail. In fact, existing law seems to expressly contemplate that an election might not be conducted entirely by mail. See, e.g., proposed Section 5115(d), which provides:

> Except for the meeting to count the votes required in subdivision (a) of Section 5120, an election *may* be conducted entirely by mail *unless otherwise specified in the governing documents*.

(Emphasis added.) See also proposed Section 5105(b), which provides for "nomination of candidates *from the floor of membership meetings*" in an election conducted under the secret ballot procedure. (Emphasis added.) That provision would be meaningless if existing law precluded secret ballot elections being conducted at member meetings.

Because the proposed law would not add the meeting language and because the existing language does not seem incompatible with the election procedure provided under existing law, the staff is inclined against making any change to the meeting language in proposed Section 5605.

Special Quorum Rule

Proposed Section 5605(a) and (b) require that certain assessment decisions be approved by a "majority of a quorum" of the members. The RPLS Working Group believes that this is a substantive change, because existing law also provides a special quorum rule for those decisions: "'quorum' means more than 50 percent of the owners of an association." See Section 1366. In order to continue the substance of that rule, the group suggests revising Section 5605 to add: "For purposes of this section, the required quorum is more than 50% of the members." See Memorandum 2010-36, Exhibit p. 173.

The group may have overlooked proposed Section 5605(c), which would provide:

> For the purposes of this section, "quorum" means more than 50 percent of the voting power of the association.

The staff believes that provision would preserve the substance of the existing special quorum rule. What's more, Memorandum 2010-57 recommends, at page 36, that proposed Section 5605(c) be revised to read as follows:

> (c) For the purposes of this section, "quorum" means more than 50 percent of the members.

With that revision, the language would even more clearly continue the existing quorum rule. **No further change seems to be needed.**

On a related point, Sun City asks why proposed Section 5605 precludes an owner of more than two separate interests from participating in an election

under that section. See Memorandum 2010-57, Exhibit p. 3. **The staff sees no such limitation in proposed Section 5605.**

☞ ASSESSMENT PAYMENT

Proposed Section 5655(a) would continue an existing provision governing the payment of assessments, thus:

> Any payments made by the owner of a separate interest toward assessments shall first be applied to the assessments owed, and, only after the assessments owed are paid in full shall the payments be applied to the fees and costs of collection, attorney's fees, late charges, or interest.

That provision does not continue all of the language of the existing provision, which reads:

> Any payments made by the owner of a separate interest toward *the debt set forth, as required in subdivision (a),* shall first be applied to the assessments owed, and, only after the assessments owed are paid in full shall the payments be applied to the fees and costs of collection, attorney's fees, late charges, or interest.

See Section 1367.1(b) (emphasis added). The italicized language was omitted out of concern that it might be read as a substantive limitation on the provision, rather than just a helpful reference to the procedure for providing notice of overdue assessments. A note following proposed Section 5655 asked for input on the merits of the proposed deletion, thus:

> **Note**. Existing Section 1367.1(b) refers to payments made toward "the debt set forth, as required in subdivision (a)…." The purpose of that language is unclear and it is potentially problematic. It could be understood as limiting the right established in Section 1367.1(b) to debts that have been properly noticed, pursuant to Section 1367.1(a). In other words, if the association makes a technical mistake in describing the debt, the member's right to pay off the principal first might not apply. The staff sees no policy reason for such a result. The limiting language would not be continued in proposed Section 5655.

The RPLS Working Group finds the explanation provided in the note unconvincing. They do not offer any other explanation for the deleted language. Nor do they express an opinion on whether the language should be deleted. See Memorandum 2010-36, Exhibit p. 176.

Perhaps a better justification for the deletion would be that the "principal first" payment policy should apply to all assessment debt, regardless of whether the member has been formally dunned pursuant to proposed Section 5660 (which would continue the notice provisions of Section 1367.1(a)). To the extent that the deleted language provides otherwise, it is bad policy and should be deleted. To the extent that it is not intended as a substantive limitation, it is unnecessary and confusing and should be deleted.

The Commission needs to discuss this issue before making a decision on how to address it.

ASSESSMENT COLLECTION

Secondary Address Delivery

Existing Sections 1365.1(c) and 1367.1(k) provide that a member may have certain specified documents delivered to two addresses (provided by the member). Proposed Section 4040 would generalize that option, so that a member may require that all "individual delivery" notices be sent to two specified addresses.

The RPLS Working Group objects to that substantive change. The group feels that delivery of all documents to a second address could create troubling legal and privacy problems. See Memorandum 2010-36, Exhibit pp. 170-71.

The staff is skeptical that the privacy concerns are justified. The double mailing is only required on the specific written request of the member. A member who requests such double mailing could not reasonably complain that compliance with the request violates the member's privacy.

The group's concern that double mailing might cause legal problems, with respect to notices that have legal significance under fair debt collection and bankruptcy law, are harder to evaluate. To do so, the staff would need more information about the specific nature of the concern.

However, the group's concern that double mailing of ballots could lead to fraud or other problems in the election process seems correct.

On balance, the staff believes that the proposed substantive broadening of the double mailing requirement is probably too controversial for inclusion of the proposed law. **Consequently the staff recommends that proposed Section 4040(b) be revised to preserve the scope of existing law, thus:**

(b) A member may request ~~in writing~~ , pursuant to Section 5260, that ~~a notice~~ the following documents be delivered to that member ~~be sent to up to~~ at two different addresses:

(1) The documents to be delivered to the member pursuant to Article 7 (commencing with Section 5300) of Chapter 5.

(2) The documents to be delivered to the member pursuant to Article 5 (commencing with Section 5650) of Chapter 6, and Section 5710.

The reference to "Section 5260" in the introductory clause above would implement a change recommended on page 66 of Memorandum 2010-57.

If the approach described above is taken, the staff recommends that proposed Section 5675 be revised to delete subdivision (f) of that section as redundant:

~~(f) Upon receipt of a written request by an owner identifying a secondary address for purposes of collection notices, the association shall send additional copies of any notices required by this section to the secondary address provided. The association shall notify owners of their right to submit secondary addresses to the association, in the annual policy statement prepared pursuant to Section 5310. The owner's request shall be in writing and shall be mailed to the association in a manner that shall indicate the association has received it. The owner may identify or change a secondary address at any time, provided that, if a secondary address is identified or changed during the collection process, the association shall only be required to send notices to the indicated secondary address from the point the association receives the request.~~

A cross-reference to that provision in proposed Section 5310(a)(2) would also need to be deleted:

5310. (a) Within 120 days after the end of the 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 all of the following information:

…

(2) A statement explaining that a member may submit a request to have notices sent to up to two different specified addresses, pursuant to subdivision (b) of Section 4040 ~~and subdivision (f) of Section 5675~~.

The staff recommends that those changes be made.

Notice of Delinquent Assessment

Proposed Section 5660 would continue existing provisions governing the content of a notice of delinquent assessment, which must be delivered to a member as a prerequisite to the recording of a lien.

The proposed law would replace an obsolete reference to record inspection under Corporations Code Section 8333, with an updated reference to the Davis-Stirling Act provision on record inspection (proposed Section 5205).

The RPLS Working Group is concerned that any change in the notice content requirements might invalidate a notice prepared under the former law. They strongly urge the Commission to make clear that the new law does not retroactively invalidate documents prepared under former law. See Memorandum 2010-36, Exhibit p. 177.

That is a valid concern. However, the staff believes that the issue should be addressed globally. See "Application of the Proposed Law" below.

Procedural Violation

Proposed Section 5675(g) would continue an existing provision that requires an association to restart the collection process, with a new notice of delinquency, if it violates any of the procedures provided in "this section."

The RPLS Working Group believes that the provision is misplaced and should be recast as a separate section. See Memorandum 2010-36, Exhibit p. 179.

The staff agrees that the provision is misplaced. Its scope has been inadvertently narrowed. Under existing law it refers to the procedural requirements of Section 1367.1 as a whole. As drafted in the proposed law, it only refers to one portion of those procedures (those expressed in Section 1367.1(d), (k)). To preserve the existing scope of the provision, it should refer to the procedural requirements of "this article." **The staff recommends that proposed Section 5675(d) be deleted and its substance continued in a new proposed section, thus:**

> **§ 5690. Procedural violation**
>
> 5690. An association that fails to comply with the procedures set forth in this article shall, prior to recording a lien, recommence the required notice process. Any costs associated with recommencing the notice process shall be borne by the association and not by the owner of a separate interest.

Comment. Section 5690 continues former Section 1367.1(*l*) without change, except that "section" has been changed to "article."

"Initiating Foreclosure"

Proposed Section 5705(c) requires an affirmative vote of the board in order to "initiate foreclosure of a lien for delinquent assessments that has been validly recorded…." The board's "vote to foreclose on a lien shall take place at least 30 days prior to any public sale."

The RPLS Working Group comments that there is considerable practitioner uncertainty as to the meaning of "initiating" foreclosure. The uncertainty comes from the 30-day period noted above, which "does not fit any recognized period in a nonjudicial foreclosure." See Memorandum 2010-36, Exhibit p. 181.

The group suggests that the section be revised to make sense of the 30-day time period. **This issue is important, but its resolution would require more study and public input than is possible in the context of the current study. It should be noted for consideration as part of a separate study of the finance provisions of the Davis-Stirling Act.**

☞ **"Legal Representative"**

Proposed Section 5710(b) would continue an existing foreclosure procedure that requires service of a notice of default be served "on the owner's legal representative…." The provision then defines "the owner's legal representative" as follows:

> The owner's legal representative shall be the person whose name is shown as the owner of a separate interest in the association's records, unless another person has been previously designated by the owner as his or her legal representative in writing and mailed to the association in a manner that indicates that the association has received it.

The RPLS Working Group finds this provision confusing:

> The provision in proposed Section 5710 continuing section 1367.1(j) regarding an owner's legal representative is confusing and will create significant legal jeopardy for any association trying to comply with the requirements of this section.
>
> Essentially, the proposed section appears to say that unless the owner has identified *another* person as his or her legal representative, the owner's legal representative for purposes of personal service *is* the owner (or possibly a co-owner). This language creates a messy situation in that only owners who occupy

> their units are subject to personal service of a notice of default (or decision to foreclose pursuant to Section 5705), while owners *qua* legal representatives must be served in *all* cases, regardless of what residence they occupy.
>
> Another troubling vagueness is that a "legal representative" might also be "the owner of *a* separate interest" (emphasis added to the indefinite article, to show that no particular separate interest is indicated and thus might be referring to the owner of *any* unit). We hope the CLRC can help untangle this drafting problem and fashion a provision that counsel and directors can understand.

See Memorandum 2010-36, Exhibit p. 181 (emphasis in original).

The staff agrees that the provision could be improved. For example, proposed Section 5710(b) could be revised as follows:

> (b) In addition to the requirements of Section 2924, ~~a notice of default shall be served by the association on the owner's legal representative~~ the association shall serve a notice of default on the person named as the owner of the separate interest in the association's records or, if that person has designated a legal representative pursuant to this subdivision, on that legal representative. Service shall be in accordance with the manner of service of summons in Article 3 (commencing with Section 415.10) of Chapter 4 of Title 5 of Part 2 of the Code of Civil Procedure. ~~The owner's legal representative shall be the person whose name is shown as the owner of a separate interest in the association's records, unless another person has been previously designated by the owner as his or her~~ An owner may designate a legal representative in a writing ~~and~~ that is mailed to the association in a manner that indicates that the association has received it.

The staff is unsure whether this revision would be too ambitious to be included in the proposed law. If so, the issue could be noted for possible future study.

Assignment or Pledge

Proposed Section 5735 would continue existing limitations on an association's ability to voluntarily assign or pledge the right to collect assessments, or to enforce or foreclose a lien.

The RPLS Working Group suggests that the section be moved, so that it would be adjacent to proposed Sections 5620 (exemption of some assessment income from execution by judgment creditor) and 5625 (limitation on use of property tax valuation in setting assessments). The group suggests that the three

provisions are related in substance and history and should not be separated. See Memorandum 2010-36, Exhibit p. 186.

The staff recommends against making that change, at least without further explanation of the reason. The provisions are not co-located under existing law. Each is in a different section of the Davis-Stirling Act. What's more, the subjects that they address seem sufficiently different that there is no need for adjacency. Finally, proposed Section 5735 is subject to an application date limitation that does not affect the other two provisions. See proposed Section 5740. Moving the provisions to be adjacent to one another would introduce application date complexities that don't exist under the proposed organization.

☞ APPLICATION OF THE PROPOSED LAW

As discussed above, under "Notice of Delinquency," the RPLS Working Group is concerned that a technical change in a statutory form might call into question the legitimacy of forms prepared under the former law. They urge the Commission to add language to prevent that result.

The staff sees the problem and agrees that it should be addressed. However, rather than do so piecemeal, it would be better to adopt a broad provision that applies to the entire proposed law.

For example, a new preliminary provision could be added at the beginning of the proposed law, along the following lines:

> 4010. Nothing in this Act shall be construed to invalidate a document prepared or action taken before January 1, 2013, if the document or action was proper under the law governing common interest developments at the time that the document was prepared or the action was taken.
>
> **Comment**. Section 4010 is new. It makes clear that any changes to former law introduced by this Act shall not be construed to retroactively invalidate documents prepared or actions taken prior to the operative date of the Act.

Should such a provision be added?

Respectfully submitted,

Brian Hebert
Executive Secretary