Study H-853 March 30, 2004

Memorandum 2004-20

State Oversight of Common Interest Developments (Discussion of Issues)

The Commission has decided to investigate the possibility of establishing a state agency to oversee common interest developments and assist in the resolution of CID disputes. That decision was made in response to continuing concerns the Commission has heard about the practical problems that homeowners face when trying to enforce an association's governing documents or CID law. Under existing law, the only effective means of enforcement is litigation, which many homeowners cannot afford.

A state oversight agency could assist homeowners in resolving disputes. It could provide information and advice and act as an intermediary in an attempt to resolve a dispute informally. Where a dispute is not amenable to informal resolution, an agency could take steps to adjudicate the dispute and order appropriate relief. This could provide an affordable alternative to litigation.

This memorandum is divided into the following sections:

- Experience in Other Jurisdictions
- Regulatory Models from California
- Administrative Adjudication
- Administrative Rulemaking
- Agency Location
- Funding
- Should California Oversee CIDs?

After reviewing these topics, the Commission should make general decisions about whether to proceed with the development of a state oversight proposal and, if so, its broad outlines. Future memoranda would develop implementing details consistent with the Commission's general decisions.

EXPERIENCE IN OTHER JURISDICTIONS

A number of jurisdictions provide administrative mechanisms for resolution of CID disputes and enforcement of CID law. For the purposes of this discussion, the various approaches are grouped into four categories:

(1) *Information and advice.* The least intrusive assistance a government can provide is to educate homeowners about the law and about available dispute resolution alternatives.

(2) *State-assisted mediation or arbitration.* Some jurisdictions require that the parties to a CID dispute participate in mediation or nonbinding arbitration before bringing a lawsuit. In addition, some jurisdictions actively support the ADR process by maintaining a list of approved mediators or arbitrators or by subsidizing the cost.

(3) *Informal intervention.* A government employee may serve as an informal intermediary, negotiating with disputants in an attempt to reach some mutually agreeable resolution.

(4) *Law enforcement.* A government agency may investigate an alleged violation of the law, hold a formal adjudicative hearing, and issue appropriate relief (which may include penalties).

A jurisdiction may choose to implement more than one of these approaches. For example, in Nevada the Ombudsman for Owners in Common Interest Communities provides information and advice, facilitates mediation, and acts as an informal intermediary. Unresolved disputes involving an alleged violation of the law are referred to the Nevada Commission for Common Interest Communities for adjudication and enforcement action.

A partial survey of CID oversight programs in other jurisdictions is provided below. Where information on the success rate of these programs is available it has been provided. If the staff receives additional information, it will be presented at the meeting.

Information and Advice

Common Interest Community Association Liaison

Virginia maintains a Common Interest Community Association Liaison in its Department of Professional and Occupational Regulation. The Liaison has the following duties:

> [Serve] as an information resource on issues relating to the governance, administration and operation of common interest communities, including the laws and regulations relating thereto. Such information may include nonbinding interpretations of laws

> or regulations governing common interest communities and referrals to public and private agencies offering alternative dispute resolution services, with a goal of reducing and resolving conflicts among associations and their members.

See Va. Code Ann. § 55-530.

The Liaison supports a privately maintained CID information website (see www.virginiaca.net) and also provides information on its own website, including information about available mediation services (see www.state.va.us/dpor/cic_lias.htm). It also funds various educational events and publications.

The Liaison maintains a telephone number for homeowner inquiries, receiving about 1,200 calls per year. The Liaison provides information and advice, but does not intervene in disputes.

Liaison operations are funded by an annual fee of $25 per association. There are estimated to be 24,000 associations in Virginia, of which approximately 4,000 have registered, yielding around $100,000 in annual revenue.

Leasehold Advisory Service

Great Britain provides a Leasehold Advisory Service. Its purpose is to give legal advice concerning housing disputes to anyone who asks for it. It is overseen by a board consisting of representatives of all stakeholders in the housing market.

The concept of this operation is that many disputes are not settled because parties are unaware of, or have a mistaken conception of, their legal rights. By providing independent legal advice to all, the agency helps people involved in disputes understand their legal rights better, which in turn makes them more realistic in coming to a resolution of their differences.

Advice is provided by telephone, written correspondence, email, or in person. The Leasehold Advisory Service publishes information and advice on its website (see www.lease-advice.org) and in print. In addition, the Advisory Service provides training to local authorities, housing associations and professional bodies.

The Advisory Service's seven consultants processed nearly 27,000 inquiries in 2003. The Advisory Service has an annual budget of £ 580,000 per year (approximately $1,043,000). Funds are provided by government grant.

State-Assisted Mediation or Arbitration

In some jurisdictions, participation in mediation or nonbinding arbitration is required as a prerequisite to litigation of a CID dispute. In Hawaii, Nevada, and Florida the state takes steps to actively support the ADR process.

Hawaii

In Hawaii, the Real Estate Commission maintains a list of local mediation centers that are under contract to the state to mediate condominium governance disputes. The state subsidizes the mediation of specified types of disputes. The parties to a subsidized mediation pay only a modest fee.

The Real Estate Commission also offers information and advice to condominium homeowners and their boards. It publishes information on the Internet and in print, and responds to specific inquiries. In 2003, the Commission answered nearly 26,000 requests for information or advice.

The Real Estate Commission's educational function and its mediation subsidy are funded by a $4 per unit annual fee on registered condominium associations. In 2003, over 1,400 associations were registered, representing a total of over 134,000 units. This yielded over $536,000 in revenue.

Nevada

In Nevada, the Real Estate Division of the Department of Business and Industry maintains a list of mediators and arbitrators that it has approved based on their training and experience in resolving CID disputes. Disputants must choose a mediator or arbitrator from the list. If they cannot agree, the Division will choose the mediator or arbitrator. In general, the parties are responsible for the cost of ADR, but the state has discretion to pay the mediator or arbitrator. See Nev. Rev. Stat. §§ 38.300-38.360.

Florida

In Florida, the Division of Florida Land Sales, Condominiums, and Mobile Homes of the Department of Business and Professional Regulation maintains a staff of attorneys who serve as arbitrators in certain condominium disputes. The petitioner must pay a $50 filing fee, but the cost of the arbitrator is otherwise borne by the state. See Fla. Stat. Ann. § 718.1255.

Florida's program has an annual budget of around $450,000 and a staff of five attorney-arbitrators and one mediator. It processes about 625 cases a year. Florida reports that fewer than 5% of the cases that are resolved through

arbitration are challenged in the courts. A Florida state task force has recently recommended that the condominium arbitration program be expanded to apply to all community association disputes. See Florida Department of Business and Professional Regulation, Final Report of the Homeowners' Association Task Force (2004).

A bill that is currently before the Florida Legislature, SB 2498 (Garcia), would establish an ombudsman within the Division of Florida Land Sales, Condominiums, and Mobile Homes. The ombudsman would accept and investigate homeowner complaints.

Mandatory Mediation Pilot Project

The Commission previously considered the question of whether participation in ADR should be a mandatory prerequisite to filing a lawsuit in a CID dispute. The Commission decided against recommending mandatory ADR at that time, with the understanding that it would reconsider its decision after the release of a Judicial Council report analyzing a mandatory mediation pilot project in Los Angeles County. See *Alternative Dispute Resolution in Common Interest Developments,* 33 Cal. L. Revision Comm'n Reports 689, 702-03 (2003). The latest prediction was that the Judicial Council report would be available in March 2004. The staff will prepare a memorandum discussing the pilot project results for consideration at a future meeting.

Informal Intervention

Nevada has a state office of Ombudsman for Owners in Common Interest Communities within the Real Estate Division of the Department of Business and Industry. The Ombudsman has the following responsibilities:

(1) To assist in processing claims submitted for mediation or arbitration pursuant to Nevada's mandatory ADR statute (see discussion above).
(2) To assist owners to understand their rights and responsibilities, including publishing materials relating to rights and responsibilities of homeowners.
(3) To assist board members to carry out their duties.
(4) To investigate disputes involving community association law or the governing documents of an association and assist in resolving such disputes.
(5) To compile a registry of CID associations.

See Nev. Rev. Stat. Ann. § 116.625.

The Nevada Ombudsman handles approximately 3,000 complaints a year. The Ombudsman's office is funded by a fee of $3 per unit per year. In 2003, the Ombudsman collected fees from about 85% of Nevada's estimated 322,000 units, yielding approximately $800,000 in revenue.

Law Enforcement

Hawaii

Hawaii's Real Estate Commission has authority to investigate violations of specific statutes under its jurisdiction. If it finds a violation it can issue a cease and desist order or seek a court injunction. A violation may also be referred for prosecution as a crime. See Haw. Rev. Stat. §§ 514A-46 - 514A-49. For the most part this authority is limited to laws governing the development and sale of condominiums. However, one of the provisions that can be enforced administratively is a requirement that members have access to association records. See Haw. Rev. Stat. § 514A-83.5. The staff does not know the number of such cases investigated by the Real Estate Commission.

Nevada

In 2003, Nevada created a new oversight body, the Commission for Common Interest Communities. See Nev. Rev. Stat. §§ 116.745-116.750. The Commission for Common Interest Communities is charged with collecting specified types of information about common interest communities, developing and promoting various educational programs, developing standards for mandatory mediation and arbitration of CID disputes, and developing a program to certify and discipline community managers.

In addition, the Commission for Common Interest Communities has authority to adjudicate an alleged violation of the common interest community statutes and regulations. It may not adjudicate disputes involving an association's governing documents.

A person who believes that there has been a violation of law must first provide notice to the alleged violator. The notice requirements are designed to provide an opportunity to correct the problem informally. If the problem is not corrected, the aggrieved person may file an affidavit with the Real Estate Division. The affidavit is referred to the Ombudsman who will attempt to resolve the problem by informal means. If the problem cannot be resolved with the Ombudsman's assistance, the Real Estate Division conducts an investigation to

determine whether there is good cause to proceed with a hearing. If there is good cause to proceed, the complaint is heard by the Commission or by a hearing panel appointed by the Commission. The Commission has authority to issue subpoenas, which are enforceable by court order.

The Commission has a number of remedies at its disposal. It may issue an order requiring that the violator cease and desist from unlawful conduct or take affirmative action to correct conditions resulting from a violation. It can impose an administrative fine of up to $1,000 per violation. The Commission may also order an audit of an association or require that a board hire a certified community manager. A boardmember or other officer who has knowingly or willfully violated the law can be ordered removed from office.

In general, a boardmember or other officer is not personally liable for a fine. However, if a boardmember or other officer is found to have knowingly and willfully violated the law, that officer may be held personally liable for a penalty.

The Commission is comprised of five gubernatorial appointees, with the following qualifications:

(a) One homeowner who has served on an association board.
(b) One developer.
(c) One member who holds a permit or certificate [i.e., a property manager].
(d) One certified public accountant.
(e) One attorney.

The Commission is too new to have meaningful data on its workload or rate of success.

Montgomery County, Maryland

Montgomery County, Maryland, has by ordinance adopted a complete scheme for nonjudicial resolution of CID disputes. The scheme was established in 1991, following a task force study that identified a number of major concerns and issues, including inequality of bargaining power and the need to provide for due process in fundamental association activities. The law creates a county Commission on Common Interest Communities that, among other activities, seeks to reduce the number and divisiveness of disputes, provide and encourage informal resolution of disputes, or (if necessary) conduct formal hearings. The Commission on Common Interest Communities law is found at Chapter 10B of the Montgomery County Code.

The Commission is composed of 15 voting members appointed by the County Executive, consisting of six CID residents, six CID professionals, and three real estate professionals. It also has non-voting designees of heads of major county departments (including planning, environment, public works, transportation, housing, and community affairs).

There is a well-articulated dispute resolution process. A dispute may not be filed with the Commission until the parties have made a good faith attempt to exhaust all procedures provided in the association documents, and at least 60 days have elapsed since those procedures were initiated. The Commission has jurisdiction to handle disputes involving:

- The authority of the board under the law or governing documents of the association to (1) require a person to take any action involving a unit, (2) require a person to pay a fee, fine, or assessment, (3) spend association funds, or (4) alter or add to a common area.
- The failure of the board to (1) properly conduct an election, (2) give adequate notice of a meeting, (3) properly conduct a meeting, (4) properly adopt a budget or rule, (5) maintain or audit books and records, or (6) allow inspection of books and records.

When an association learns of a dispute, it must notify the parties of the right to file with the Commission. An association may not take further action on the dispute until 14 days after the notification and, once the dispute has been filed with the Commission, may take no further action until it has been resolved by the Commission. In any pending civil action, the court may issue a stay of up to 90 days to allow the Commission's process to reach its conclusion.

The Commission will provide mediation services to the parties on request. If mediation fails, or is rejected by a party, the dispute goes to a hearing.

The hearing is held before a panel appointed by the Commission Chair. It consists of one residential member of the Commission, one Commission member from one of the other represented groups, and an outside volunteer selected by the two members who has arbitration experience. The arbitrator chairs the hearing panel.

Alternatively, the Commission Chair may refer the matter (or the parties may agree) to a County hearing officer; in that case the hearing officer's decision is subject to review by a hearing panel.

The hearing is conducted pursuant to standard county administrative hearing procedures. The Commission may compel production of books and records and

attendance of witnesses, and may invoke the court's contempt power. The hearing panel may resolve the dispute, may award damages, and may award costs and attorney's fees in appropriate situations. Its decision is binding on the parties.

The hearing panel's decision is subject to judicial review on three grounds only — the decision does not comply with law, it is not supported by substantial evidence, or it is arbitrary and capricious. The court may award costs and fees. A failure to comply with the decision is a civil offense, and the decision is enforceable by the full enforcement mechanisms of the county, including the County Attorney.

Great Britain Housing Ombudsman

Great Britain has an Independent Housing Ombudsman. The jurisdiction of that office does not cover the British equivalent of CID housing; however, it does cover similar community housing issues arising out of the landlord-tenant relationship in what are basically public housing complexes. The Ombudsman receives tenant complaints and resolves them free of charge.

The office uses a number of dispute resolution techniques, including informal intervention, formal inquiry, mediation, arbitration, and final recommendation. It rarely conducts hearings, performing most of its work on the basis of paper submissions. The operation appears to have been successful, keeping the bulk of these disputes out of court.

The office has quasi-judicial powers. Its final recommendations are determinative, but are judicially reviewable.

Australia

Australia has state-run dispute resolution programs for "strata schemes" (including condominiums) in three states: New South Wales, Queensland, and Western Australia.

New South Wales has the most fully-developed program. The agency (Strata Schemes & Mediation Services) includes a commissioner, full-time mediators, adjudicators, and an appeals board. The agency provides governmental oversight and public information, as well as dispute resolution services, and employs customer service officers who provide free information to the public on the governing laws. The agency is funded by the state, but a person submitting a dispute for resolution must pay a filing fee of $58 AUS (approximately $43 US).

A dispute is first submitted to mediation with a government-provided mediator. Mediation typically takes about five weeks to complete. If mediation fails or is deemed inappropriate, the case proceeds to adjudication. There is a written adjudication system, which is based on the documentary record. It takes about 14 weeks to complete. A decision reached through written adjudication may be appealed to an administrative "tribunal" which holds a formal hearing to decide the matter. Tribunal hearings take about twelve weeks to complete. Cases may also be appealed to the courts, though that is very rare.

In 2003, there were 918 applications submitted for adjudication in New South Wales (out of approximately 750,000 "strata scheme" housing units).

The programs in Queensland and Western Australia are less fully developed, but include some combination of mediation or conciliation, paper-based adjudication, and appeal to a specialist tribunal.

REGULATORY MODELS FROM CALIFORNIA

There are a number of agencies in California that oversee disputes between private parties, typically to protect the rights of consumers. A few representative examples are described below.

Mobilehome Ombudsman

California's Mobilehome Ombudsman (in the Department of Housing and Community Development) helps to resolve complaints from the public relating to manufactured homes and mobilehomes, including titling and registration, installation, warranties, financing, sales, inspections, and problems involving the Mobilehome Residency Law (the equivalent of the Davis-Stirling Act for mobilehome parks). See Health & Safety Code § 18151. The Ombudsman may not arbitrate, mediate, negotiate, or provide legal advice on mobilehome park rent disputes or problems arising from lease or rental agreements, but may provide information on these issues. Section 18151(c).

The Ombudsman uses the following general procedure:

(1) If a complainant requests residency law information only, the ombudsman assists over the phone and sends a copy of the law.

(2) If a complainant requests complaint processing assistance with a problem other than rental agreements or rent disputes, a complaint form will be sent to the complainant.

(3) When a complaint form is received and it relates to a Mobilehome Residency Law issue, a copy of the complaint is sent to the park

manager for resolution. The Ombudsman does not participate any further.

(4) A complaint involving a violation of other laws within the jurisdiction of the Housing and Community Development department is referred to the appropriate unit of that department for enforcement action.

Staff inquiries suggest that the Department of Housing and Community Development is not currently allocating significant resources to the Ombudsman function. There are no dedicated Ombudsman staff. The Ombudsman phone line is answered only one hour per day.

Department of Consumer Affairs

The Department of Consumer Affairs oversees a wide range of professions in order to protect consumers. It describes itself as follows (see www.dca.ca.gov/aboutdca/morabout.htm):

> To promote and protect the interests of consumers, the Department licenses and regulates 2.3 million professionals in more than 230 different professions, including doctors, dentists, contractors, cosmetologists and auto-repair technicians. The Department of Consumer Affairs includes 40 regulatory entities (nine bureaus, one program, twenty-four boards, three committees, one commission, one office and one task force). These entities establish minimum qualifications and levels of competency for licensure. They also license, register, or certify practitioners, investigate complaints and discipline violators. The committees, commission and boards are semiautonomous bodies whose members are appointed by the Governor and the Legislature. DCA provides them administrative support. DCA's operations are funded exclusively by license fees.

To illustrate the approach taken by DCA generally, it is helpful to examine the procedures of one of its subordinate entities: the Bureau of Automotive Repair. See Bus. & Prof. Code §§ 9880-9889.68. The bureau regulates automotive repair businesses and technicians. In the Fiscal Year 2001-2002, the bureau processed over 24,000 consumer complaints.

Most of the complaints the bureau receives are handled through its "telephone mediation" service. Telephone mediators collect information from the complainant and the respondent, including relevant documents. The mediator then attempts to reach some negotiated settlement of the dispute. Telephone mediation is successful in the majority of cases.

If mediation fails, the complainant may file an action in small claims court, and can subpoena the information collected by the bureau in the mediation process. If the mediator determines that there may have been a violation of a law within the bureau's enforcement jurisdiction, it will refer the case to the relevant enforcement unit. The mediation center employs approximately 40 telephone mediators.

A violation of law can be punished by suspension, revocation, or nonrenewal of a business' registration or a technician's license. Such an action can only be taken after an evidentiary hearing. These hearings are conducted by the Office of Administrative Hearings.

A violation can also be punished by issuance of a citation (with a civil penalty of $500 to $2,500). A citation may be appealed, in a hearing conducted by the Office of Administrative Hearings.

Final decisions are subject to judicial review by a writ of administrative mandamus.

Department of Fair Employment and Housing

The Department of Fair Employment and Housing is charged with enforcing California's employment, housing, public accommodations and public service non-discrimination laws, as well as the State's bias-related hate violence law. See Gov't Code §§ 12900-12996. The Department receives and investigates discrimination complaints and provides technical assistance to employers, business establishments, and housing providers regarding their responsibilities under the law. A complainant may choose to engage in mediation before filing a formal complaint, or may skip mediation and proceed directly to formal investigation and adjudication.

Mediation

In 2001, the Department launched a pilot program for mediation of employment discrimination cases. The Department found that 56% of all cases that were mediated were successfully resolved. Mediated cases were resolved 3.55 times faster and cost 3.8 times less than cases that were fully investigated by the Department. The program was deemed successful and made permanent. The Department estimates that it will mediate about 2,400 employment disputes per year (of the 18,000 employment complaints it currently receives each year). In 2003, the Department added a parallel program for mediation of housing

discrimination cases. See Evaluation Report of the DFEH Pilot Mediation Program (4/3/2003) (available at www.dfehmp.ca.gov/News/news.asp).

If both parties agree to mediation, a mediator is assigned by the Department. The mediator is selected from a list of mediators who are under contract to the state. There is no cost to the parties for participation in mediation.

Investigation

If a complaint is not resolved through mediation, it proceeds to formal investigation. The complainant is interviewed to collect facts about the case. The complaint is written up by the Department and served on the respondent. The Department has power to subpoena witnesses, take depositions and interrogatories, and compel the production of books and records. If a party fails to comply with the Department discovery orders, the Department can file a petition in superior court to compel compliance.

Conciliation

If the Department determines that a complaint is valid, it attempts to resolve the complaint through "conference, conciliation and persuasion." Statements made in the conciliation process are confidential. If the dispute is resolved through conciliation, the agreement is reduced to writing and signed by all parties. Within a year of execution of an agreement, the Department will conduct a compliance review. If it finds noncompliance it can bring an action in superior court to enforce the agreement.

Adjudication

If conciliation fails, the Department may bring a case for administrative adjudication, on behalf of the complainant. The complaint is heard and decided by a separate agency, the Fair Employment and Housing Commission. The Commission has seven members, appointed by the Governor with the advice and consent of the Senate.

The Fair Employment and Housing Commission can order a range of equitable remedies, including reinstatement of an employee, restitution of out of pocket expenses, injunction, and the issuance of administrative fines. Within specified dollar limits, the Commission can also award damages for emotional distress.

Any party may elect to have a case transferred from administrative adjudication to the superior court. The Department continues to represent the complainant in the judicial proceeding.

A decision of the Commission is subject to judicial review by writ of administrative mandamus. The Commission's decision is enforced by petitioning the superior court for a decree enforcing the decision.

Other Relevant Agencies

There are two other agencies with jurisdictions that relate to CIDs, but that are not currently involved in significant oversight of CID disputes. They are discussed briefly below:

Attorney General

Corporations Code Section 8216 authorizes the Attorney General to act on behalf of a member, director, or officer of a mutual benefit corporation who complains about a failure of the corporation to comply with specified provisions of the Corporations Code (relating to meetings, elections, document filing, record-keeping, and access to records). The Attorney General may send "notice of the complaint" to the corporation. If the corporation does not respond within 30 days, or if its response is unsatisfactory, the Attorney General may:

> [Institute], maintain or intervene in such suits, actions, or proceedings of any type in any court or tribunal of competent jurisdiction or before any administrative agency for such relief by way of injunction, the dissolution of entities, the appointment of receivers, or any other temporary, preliminary, provision or final remedies as may be appropriate to protect the rights of members or to undo the consequences of failure to comply with such requirements.

On its face, that would seem to provide a mechanism for state oversight of CID disputes. However, as a matter of policy, the Attorney General does not pursue legal action in CID cases. See the discussion in Memorandum 2001-44 (May 3, 2001).

Department of Real Estate

The Department of Real Estate licenses and regulates real estate brokers, salespersons, and subdividers. See Bus. & Prof. Code § 10000 *et seq*. If it determines that a law under its enforcement jurisdiction has been violated it may issue a "desist and refrain" order. The Department may also take steps to deny, suspend, or revoke a violator's license (after a hearing conducted by the Office of

Administrative Hearings). The laws enforced by the Department relate to sale and development of property and do not encompass CID governance after the period of developer control.

ADMINISTRATIVE ADJUDICATION

There are a number of issues that will need to be taken into account if the Commission recommends administrative adjudication of CID disputes. Some of these issues were first discussed in Memorandum 2001-54.

Separation of Powers

Article III, Section 3, of the California Constitution provides that the powers of state government are legislative, executive, and judicial. "Persons charged with the exercise of one power may not exercise either of the others except as permitted by this Constitution." The judicial power of the state is vested in the courts. Cal. Const. art. VI, § 1.

The Constitution itself vests judicial power in a few administrative agencies, such as the Public Utilities Commission and the Alcoholic Beverage Control Appeals Board. Cal. Const., art. XII; art. XX, § 22. In addition, the Constitution expressly delegates to the Legislature the authority to provide nonjudicial dispute resolution of some matters, such as workers' compensation. Cal. Const. art. XIV, § 4.

There is a long tradition of legislative creation of regulatory agencies by statute. These agencies typically exercise adjudicative powers subject to judicial review by administrative mandamus. Statutory programs of regulation have generally been sustained against separation of powers challenges. See, e.g., 7 B. Witkin, *Summary of California Law*, Constitutional Law § 113 (9th ed. 1988). However, administrative adjudication of a dispute between two private parties (e.g., between owners of common interests in property, or between an association board of directors and a member of the association) raises special concern.

The seminal case on the issue is *McHugh v. Santa Monica Rent Control Board*, 49 Cal. 3d 348, 261 Cal. Rptr. 318, 777 P.2d 91 (1989). That case involved a rental dispute between a landlord and tenant. The case was brought before a local administrative agency pursuant to a local regulatory scheme of rent control. The administrative agency found that the landlord had overcharged; it awarded restitution of excess rent by withholding from current rental payments, as well as treble damages authorized by the regulatory scheme. The Supreme Court

invalidated the immediate withholding of rent and the award of treble damages as violations of the separation of powers doctrine.

The court in *McHugh*, departing from earlier precedent, announced that in the future it would apply a two-prong test to determine whether an administrative adjudication scheme can survive a separation of powers challenge. The first prong is a "substantive" test — is the administrative procedure reasonably necessary to accomplish the agency's regulatory purposes? The second prong is the "principle of check" — the judicial branch must retain the ultimate power of decision in the case.

Under this test, the court will carefully apply the "reasonable necessity/legitimate regulatory purpose" requirement in order to guard against unjustified delegation of authority to decide disputes that otherwise belong in the courts (49 Cal. 3d at 374 (fn. omitted)):

> Specifically, we will inquire whether the challenged remedial power is authorized by legislation, and reasonably necessary to accomplish the administrative agency's regulatory purposes. Furthermore, we will closely scrutinize the agency's asserted regulatory purposes in order to ascertain whether the challenged remedial power is merely incidental to a proper, primary regulatory purpose, or whether it is in reality an attempt to transfer determination of traditional common law claims from the courts to a specialized agency whose primary purpose is the processing of such claims.

Thus, by way of example, the court indicates that it would not approve the Board's adjudication of a landlord's counterclaims against a tenant. Such an adjudication would not reasonably effectuate the Board's regulatory purpose, and it would shift the Board's focus from ensuring the enforcement of rent levels, to adjudicating a broad range of landlord-tenant disputes traditionally resolved by the courts.

The courts since *McHugh* have shed additional light on the dimensions of the separation of power issue with respect to administrative resolution of private disputes. Cases that will be of interest to the Commission in considering whether to construct a system for administrative adjudication of CID disputes include:

- *Peralta Community College Dist. v. Fair Employment & Housing Comm'n*, 52 Cal. 3d 40, 276 Cal. Rptr. 114, 801 P.2d 357 (1990). Administrative agency, in employment discrimination proceeding, could not adjudicate compensatory damage claims for emotional and other injuries, traditionally awarded in judicial actions between private parties. The statute creating the agency did not

expressly authorize an award of general compensatory damages, and it was unlikely the Legislature would grant "unbridled power to an administrative agency to make monetary awards without guidelines or limitations." 52 Cal. 3d at 60.

- *Walnut Creek Manor v. Fair Employment & Housing Comm'n*, 54 Cal. 3d 245, 284 Cal. Rptr. 718, 814, P.2d 704 (1991). Legislative grant of authority to administrative agency to award compensatory damages in housing discrimination proceeding must be limited to special (as opposed to general) damages — the agency may award quantifiable out of pocket restitutive damages but not general compensatory damages for emotional distress and other intangible injury. "The award of unlimited general compensatory damages is neither necessary to [the regulatory] purpose nor merely incidental thereto; its effect, rather, is to shift the remedial focus of the administrative hearing from affirmative actions designed to redress the particular instance of unlawful housing discrimination and prevent its recurrence, to compensating the injured party not just for the tangible detriment to his or her housing situation, but for the intangible and nonquantifiable injury to his or her psyche suffered as a result of the respondent's unlawful acts, in the manner of a traditional private tort action in a court of law." 54 Cal. 3d at 264.
- *Konig v. Fair Employment & Housing Comm'n*, 28 Cal. 4th 743, 123 Cal. Rptr 2d 1, 50 P.3d 718 (2002). After the decision in *Walnut Creek Manor,* the Legislature added an opt-out provision — any party to a case before the Fair Employment and Housing Commission may elect to have the case adjudicated in court instead. Gov't Code § 12989. Based in large part on that change, the California Supreme Court held that an award of emotional damages by the Fair Employment and Housing Commission did not violate separation of powers. The court quoted approvingly from a federal case upholding a similar opt-out provision: "Congress gave the [Commodity Futures Trading Commission] the authority to adjudicate such matters, but the decision to invoke this forum is left entirely to the parties and the power of the federal judiciary to take jurisdiction of these matters is unaffected. In such circumstances, separation of powers concerns are diminished, for it seems self-evident that just as Congress may encourage parties to settle a dispute out of court or resort to arbitration without impermissible incursions on the separation of powers, Congress may make available a quasi-judicial mechanism through which willing parties may, at their option, elect to resolve their differences." 8 Cal. 4th at 753 (citation omitted).

The concern at issue in these cases is the award of general compensatory damages. While *Konig* suggests that general damages may be awarded in administrative adjudication so long as the parties can opt out of the administrative process and into the courts, a simpler approach would be to limit

a CID oversight agency to granting equitable relief (e.g., an order requiring member access to documents, an audit of the association's books, a declaration of the invalidity of an improperly conducted election, an order removing a member of a board, etc.). A traditional claim for damages would still be adjudicated in court (including small claims court, if appropriate).

Separation of Agency Functions

The California enforcement agencies described above all separate their investigation and enforcement functions from their adjudication function. Bureau of Automotive Repair hearings are conducted by the Office of Administrative Hearings. The Department of Fair Employment and Housing prosecutes its cases before the Fair Employment and Housing Commission. This separation of functions helps to preserve the neutrality of the adjudicator that is required under Government Code Section 11425.30. That section, enacted on the Commission's recommendation, provides that a person may not serve as "presiding officer" in an administrative adjudication if the person also served as investigator, prosecutor, or advocate in the proceeding or its pre-adjudicative stage, of if the person is subject to the authority, direction, or discretion of a person who served as investigator, prosecutor, or advocate.

Mandatory or Permissive Adjudication?

Should the administrative adjudication procedure be mandatory or permissive? When the Commission began its review of common interest development law, it found that one of the criticisms of the existing provisions relating to alternative dispute resolution was that the existing provisions are permissive rather than mandatory. A party may offer to use mediation or arbitration, but the other may reject that option, forcing the dispute into court. A further criticism was that litigation is prohibitively expensive, making it impractical for the ordinary homeowner to pursue or defend rights relating to day-to-day living arrangements.

These concerns suggest that an administrative adjudication program ought to be mandatory rather than permissive. However, for such a program to be successful, it would have to be readily accessible to associations and homeowners throughout the state. This could be accomplished either by establishing a statewide hearing infrastructure within the oversight agency or by having the Office of Administrative Hearings conduct the hearings. OAH has

offices in Sacramento, Oakland, Los Angeles, and San Diego. It is common for OAH hearing officers to travel to the exact locale where a hearing is to be held.

Another partial answer would be to hold hearings telephonically to the extent possible. Existing law permits a hearing to be held by telephone or video conference so long as all of the parties agree. See Gov't Code § 11440.30.

One final consideration — the cases on separation of powers suggest that an agency may not award general compensatory damages unless the law permits either party to opt out of administrative adjudication and into the courts. If a CID oversight agency is authorized to award general damages then the law should include an opt-out provision in cases involving such damages.

Judicial Review

Judicial review of the administrative decision is required for separation of powers purposes. Remember that *McHugh* announced a two-prong test. The first prong is the "substantive" rule that adjudicative powers be limited to those reasonably necessary to effectuate the administrative agency's primary, legitimate regulatory purposes. The second prong is the "principle of check" — the "essential" judicial power (i.e., the power to make enforceable, binding judgments) must remain ultimately in the courts, through review of agency determinations.

The court in *McHugh* noted that an opportunity for judicial review must be available before an administrative order may be enforced. Thus the rent control board's order in that case authorizing the tenant to withhold rent violated constitutional separation of powers requirements because it went into immediate effect, before the parties had an opportunity to seek judicial review.

Administrative mandamus is the appropriate means for judicial review of a decision reached in an adjudicative hearing. See Code Civ. Proc. § 1094.5. If the Commission decides to recommend an agency with adjudicative powers, the staff will prepare a discussion of the different standards of review in such a proceeding ("independent judgment" and "substantial evidence"), and whether to mandate which standard should control in reviewing CID decisions.

Precedent Decisions

Another advantage of administrative adjudication is the ability of the adjudicative agency to develop a body of "precedent decisions." These decisions can be indexed by topic and made available to the public. See Gov't Code § 11425.60. Precedent decisions provide guidance to regulated persons and help to

ensure consistent and rational development of policy by the adjudicative agency. CID homeowners and officers would benefit from such guidance, especially if it were easily accessible (e.g., by publication on the Internet).

ADMINISTRATIVE RULEMAKING

Many regulatory agencies have the authority to adopt administrative regulations. For example, the Fair Employment and Housing Commission has the following rulemaking authority (Gov't Code § 12935(a)):

> To adopt, promulgate, amend, and rescind suitable rules, regulations, and standards (1) to interpret, implement, and apply all provisions of this part, (2) to regulate the conduct of hearings …, and (3) to carry out all other functions and duties of the commission pursuant to this part.

Regulations can provide valuable guidance by interpreting ambiguous statutory provisions. Rulemaking can also be used to fill gaps, where the Legislature has granted an agency general enforcement authority but left some details up to administrative development.

A CID oversight agency should have authority to adopt regulations to define its own operations. It should probably also have authority to interpret ambiguous or incomplete provisions in the Davis-Stirling Act. This would help to relieve the pressure on the Legislature to repeatedly amend the Davis-Stirling Act to address minor defects.

AGENCY LOCATION

Should a CID oversight agency be independent or be part of an existing department? If it is made part of an existing department, which department?

We explored this question in a similar context when considering where to locate a state-run CID information center. Despite the fact that we intended to provide a funding source, the agencies we contacted were generally reluctant to accept responsibility for the new service.

Part of the concern was that the funding provided would be inadequate to handle the deluge of homeowner calls that might be triggered if an agency identifies itself as a CID information center. That problem can be addressed by guaranteeing that the agency has sufficient funding.

Another issue that needs to be considered is the political implication that might be drawn from the choice of a particular department as host. For example,

critics of the power exercised by homeowner association boards would likely approve of the Department of Consumer Affairs as a host department because of its exclusive focus on the protection of consumer rights. By contrast, the Department of Real Estate, with its focus on property development and sales, might be seen as more removed from the issues facing homeowners in existing developments.

Some of these problems could be avoided if the oversight agency were independent. However, building an agency from scratch presents practical difficulties that might be lessened if the agency were part of an existing structure.

If the Commission decides to recommend an oversight agency, the staff will consult with possible host departments to ask their advice. The Department of Consumer Affairs may be particularly helpful given its structure. Because the boards and bureaus under its jurisdiction were created over time, the Department may have specific experience starting up a new regulatory entity. It should also have existing mechanisms for providing centralized administrative support to its subordinate entities.

FUNDING

Funding Mechanism

When the Commission recommended the creation of a state-run CID information center, it decided that the service should be funded with a fee of $2 per association, collected when the association registers with the Secretary of State (every two years). Although that amount is too small to support a fully articulated oversight agency, a similar funding mechanism could be used. For example, an association could be charged a fee when it registers with the Secretary of State, based on the number of units within the association. If the fee were $3 per unit, an association of 100 units would pay a total fee of $300 (in addition to the fee charged by the Secretary of State). The $300 collected by the Secretary of State would be transferred to the oversight agency's account.

The advantages of this approach are: (1) it would spread the cost of the oversight agency to all CID homeowners, allowing the agency to provide free or low cost services to any CID homeowner who needs assistance, (2) it avoids dipping into the state's general fund (a necessity, given the state's current fiscal situation), and (3) it would piggy-back on an existing collection mechanism, sparing the oversight agency the expense and hassle of collecting fees.

Note that the State Constitution requires supermajority approval of new taxes. See Cal. Const. art XIIIA, § 3. However, a regulatory fee imposed by a government agency, under which each payor is required to pay a fixed amount, is not a tax if that the amount collected does not surpass the cost of the regulatory program that the fee supports. California Assn. of Professional Scientists v. Dept. of Fish and Game, 94 Cal. Rptr. 2d 535, 79 Cal. App. 4th 935 (2000). A fee on CID homeowners that funds services provided to CID homeowners would probably not be considered a tax.

Funding Levels

One recent estimate is that there are around 35,000 CIDs in California, with a total of 3.5 million separate housing units. The Secretary of State's office recently estimated that around 9,000 CIDs have registered since January 1, 2003. That number should increase over time as more associations learn of the registration requirement. The Secretary of State does not tabulate the number of units in the associations that register. However, if we assume an average size of 100 units per association, we can estimate that 900,000 individual units are now registered.

Nevada funds its CID oversight programs with an annual fee of $3 per unit per year. Hawaii charges $4 per year. A fee of $4 per unit in California could yield as much as $3,600,000 per year at the outset. If registration were to reach a 75% compliance rate, an annual $4 per unit fee would yield $10,500,000.

By comparison, the proposed 2004-2005 budget for the Department of Fair Employment and Housing and the Fair Employment and Housing Commission combined is around $20 million. That suggests that a $4 per unit fee might be insufficient for an ambitious oversight program. Depending on the scope of activities assigned to an oversight agency, the fee should perhaps be set higher.

Another option would be to set an initial fee amount (e.g., $5 per unit per year) and allow the agency to lower or increase the fee by regulation to match its actual costs (perhaps up to some statutory maximum). A per unit fee of $5 per year does not seem excessively burdensome, considering that the persons paying the fee are homeowners. A requirement that the fee be lowered if it produces more revenue than is needed would also help to demonstrate that the fee is not a tax.

Another partial solution would be to have a homeowner pay for some or all of the services provided by the agency. For example, the agency could institute a filing fee for submitting a complaint to adjudication. If the agency is empowered

to impose a fine (as opposed to damages), the proceeds from the fine could be paid into the agency's funds, providing another minor stream of revenue. These revenue sources would not be sufficient to cover the entire cost of the agency, but should be included in the mix.

Political Considerations

Funding has the potential to be the most controversial aspect of a proposal for state oversight. Even if funds are drawn from fees rather than the general fund, some legislators may balk at creating an entirely new agency at a time of fiscal crisis.

Homeowners in well-run associations may resent paying a fee to subsidize the resolution of problems in other communities. However, if the agency's mandate includes information provision, education, rulemaking, and the issuance of precedent decisions, then all associations will benefit from the resulting clarification of the law.

Ultimately, there may be enough discontent with the status quo to overcome any resistance to an annual fee. Small per-unit fees have been successfully instituted in Hawaii, Nevada, and Virginia. In Hawaii, condominium groups testified before the Legislature in favor of the per-unit fee and the programs it supports.

SHOULD CALIFORNIA OVERSEE CIDS?

Experience in other jurisdictions shows that there is a significant demand for government assistance with CID questions and complaints. Last year, the Virginia Liaison answered 1,200 calls, Florida arbitrated 625 condominium disputes, Nevada's Ombudsman assisted with 3,000 homeowner complaints, and Hawaii responded to 26,000 requests for information and advice. Florida is considering expanding its state oversight activities. Nevada has recently done so, creating a new body to adjudicate violations of the law.

There are a number of successful state-run consumer complaint resolution programs in California. These programs process tens of thousands of complaints every year, a significant proportion of which are resolved through some form of informal intervention or mediation. Some of these complaints result in formal investigation and, if a violation of law is found, administrative adjudication and the imposition of sanctions. These programs demonstrate the feasibility of significant state oversight of consumer complaints.

Under existing law, a homeowner in a dispute with a homeowners association has no effective way to enforce CID law other than litigation. Many homeowners do not have the resources to pursue a meritorious case, especially if no monetary damages are involved. This reduces the accountability of associations, making it easier to disregard the law when convenient to do so. The staff recently spoke with a homeowner who provided an anecdotal illustration of the problem. After last year's enactment of AB 512 (Bates), she informed her board that they are now required to provide members with notice and an opportunity to comment before making a change to the association's operating rules. Reportedly, they refused to do so, indicating that if she didn't like it, she could sue. As the board probably knew, this homeowner does not have the resources to hire a lawyer and file a lawsuit. An agency with the power to issue orders and impose penalties might have remedied this problem with a single telephone call. If the board were to resist informal resolution, an investigation and enforcement action could remedy the problem (and provide incentives to follow the law in the future). A few high profile enforcement cases would give homeowners significantly more clout when insisting on their rights.

The staff recommends that the Commission develop a proposal for creation of a state oversight agency with authority to provide information and advice, intervene informally, and investigate, adjudicate, and correct violations of law.

If the Commission decides to proceed with the development of a proposal for some form of state oversight of CIDs, the staff will prepare a memorandum discussing the details of implementation of the Commission's chosen approach, for consideration at a future meeting.

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary