Study H-853 September 14, 2004

First Supplement to Memorandum 2004-39

State Assistance to Common Interest Developments (Staff Draft)

Memorandum 2004-39 presents a staff draft tentative recommendation proposing the creation of a Common Interest Development Bureau in the Department of Consumer Affairs. On August 17, the staff met with the Director of Consumer Affairs (Charlene Zettel) to discuss the draft proposal. Some issues raised in that meeting are discussed below.

The Commission has received several letters commenting on the staff draft. Those letters are attached in the Exhibit, as follows:

Exhibit p.

1. Bruce Osterberg, Escondido (Aug. 16, 2004) 1
2. Mel Klein, email (Aug. 17, 2004) 3
3. Mel Klein, email (Aug. 20, 2004) 7
4. Mel Klein, email (Aug. 24, 2004) 8
5. Bruce Osterberg, Escondido (Sept. 9, 2004) 9
6. Mel Klein, email (Sept. 13, 2004) 10

The staff has not included attachments to these letters that document ongoing disputes within the authors' associations. Issues raised in the letters are discussed below.

DCA MEETING

The Department of Consumer Affairs is not yet able to take an official position on our proposal, but did not raise any insurmountable objections. A few significant issues raised in the meeting are discussed below.

Agency Start-Up

Some costs of organizing and starting up a new bureau would accrue before a reliable revenue stream becomes available (e.g., planning, hiring, leasing office space, adopting procedural regulations). In similar situations in the past, DCA has addressed the initial funding shortfall by temporarily loaning money from the budgets of existing DCA programs to the new program. DCA has taken that approach in the past without express statutory authorization. Nonetheless, it

might be helpful to add language specifically allowing a loan to the bureau. If the Commission decides to include such a provision, the staff will consult with DCA and the Legislative Counsel before drafting the language.

It might also make sense to defer the operation of those parts of the proposed law that impose duties, for some brief period after the bureau is created (e.g., six months). That would allow the bureau to complete necessary start-up activities before it is required to commence its substantive work. Thus, proposed Section 1380.130 could be revised along the following lines:

> 1380.130. (a) This chapter does not apply to a common interest development that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located.
>
> (b) Article 3 (commencing with Section 1380.200) and Article 4 (commencing with Section 1380.300) become operative on July 1, 2007.
>
> (c) This chapter is repealed by operation of law on January 1, 2012 unless a subsequent statute repealing this section or extending the date of repeal of this chapter is enacted and takes effect on or before January 1, 2012.
>
> ~~(c)~~ (d) The bureau is subject to review by the Joint Legislative Sunset Review Committee pursuant to Chapter 1 (commencing with Section 473) of Division 1.2 of the Business and Professions Code.

Note that the dates in the provisions set out above assume introduction of implementing legislation in 2006, with a January 1, 2007, effective date. If implementing legislation is introduced in 2005, the dates would be moved up by one year.

Bureau v. Commission

Discussions during the meeting confirmed the staff's sense that it would be politically untenable to propose the creation of a multi-member commission or board at this time. A bureau headed by an individual would be more acceptable.

The principal advantage of a multi-member body is the multiplicity of views it brings to policy deliberations. That benefit could also be achieved by appointment of an "advisory committee" established to provide policy advice to an executive officer.

An executive officer's general operational discretion might be sufficient to support creation of an advisory committee. However, express authority could be added by revising proposed Section 1380.110 along the following lines:

§ 1380.110. Common Interest Development Bureau

1380.110. …

(f) The bureau chief may convene an advisory committee to make recommendations on matters within the bureau's jurisdiction. A member of an advisory committee shall receive per diem and expenses pursuant to Section 103 of the Business and Professions Code.

Pre-Enforcement Conciliation

The proposed law would provide for administrative appeal of a citation issued by the bureau. The proposed law contains two features intended to minimize the cost of these administrative hearings:

(1) The bureau's enforcement duties would be discretionary. The bureau "may" seek to informally mediate a dispute or issue a citation, but is not required to prosecute every case. See proposed Section 1380.310(a)-(b). This is a practical necessity; the bureau may not have the resources to prosecute every case.

(2) Authority to issue a citation would only exist if "the bureau finds that a violation has occurred and that it cannot be remedied informally." See proposed Section 1380.310(b). This requires at least an attempt at informal resolution before issuing a citation.

The second point could be stated more directly, by revising proposed Section 1380.310 as follows:

§ 1380.310. Violation of law

1380.310. …

(b) If the bureau finds that a violation has occurred ~~and that it cannot be remedied informally under Section 1380.300,~~ the bureau may issue a citation by serving it on the person responsible for the violation. Before issuing a citation, the bureau shall attempt to remedy the violation informally under Section 1380.300. The citation shall cite the statute or regulation that has been violated and the facts constituting the violation. The citation shall order abatement of the violation and may order additional equitable relief as appropriate. If the bureau finds, by clear and convincing evidence, that a violation involved malice, oppression, or fraud, as those terms are defined in Section 3294, the bureau may order removal of the violator from office within a community association.

Choice of Hearing Officer

According to DCA, the cost of a hearing conducted by the Office of Administrative Hearings would be much greater than the cost of a hearing conducted in-house. However, a hearing before a member of the bureau's own

staff could raise concerns about separation of functions, especially in a small agency. Those concerns are addressed in part by Government Code Section 11425.30, which provides that a person may not serve as a presiding officer in an adjudicative proceeding if:

> (1) The person has served as investigator, prosecutor, or advocate in the proceeding or its preadjudicative stage.
> (2) The person is subject to the authority, direction, or discretion of a person who has served as investigator, prosecutor, or advocate in the proceeding or its preadjudicative stage.

The proposed law does not specify whether an administrative hearing would be conducted by the bureau itself or by the Office of Administrative Hearings. Absent a limiting rule, the bureau could choose either approach.

An alternative approach would be to allow the bureau to select the presiding officer, but provide some limiting criteria to help address concerns about the neutrality or qualification of the person selected. Food and Agricultural Code Section 55528(d) provides an example, in the context of the Market Enforcement Bureau, a subordinate entity within the Food and Agriculture Department:

> Proceedings for the revocation or denial of a license issued under this chapter shall be conducted by hearing officers appointed for that purpose by the department. The department may elect to use hearing officers employed by the Office of Administrative Hearings. The hearing officers shall be independent of the Market Enforcement Bureau, but may be employees of the department. The hearing officers shall be qualified administrative law judges.

Such a provision would allow DCA to establish a panel of ALJs to hear the bureau's appeals. Those ALJs would not be part of the bureau's hierarchy. Should the proposed law include a provision along these lines?

Imposition of Penalties

Proposed Section 1380.310(c) states criteria for the bureau to consider in deciding whether to impose an administrative fine, and if so, the amount of the fine: "the gravity of the violation, the presence or absence of just cause or excuse, and any history of prior violations." Another factor that should be added to the list is the size of the association that is subject to the fine. The cost of a fine against an association will be spread to all members of the association, through an increase in assessments. An amount that might be reasonable when spread to the members of an association of ten units would be inconsequential to an association of 10,000 units. Conversely, an amount appropriate to a very large

association would be unfairly burdensome to a very small association. The staff recommends that Section 1380.310(c) be revised as follows:

> A citation may include an administrative fine of not more than $1,000 per violation, to be paid to the bureau. In determining whether to impose a fine and the amount of any fine imposed, the bureau shall consider the size of the association, the gravity of the violation, the presence or absence of just cause or excuse, and any history of prior violations. A fine shall not be imposed against an individual unless the bureau finds, by clear and convincing evidence, that the violation committed by the individual involved malice, oppression, or fraud, as those terms are defined in Section 3294. If the bureau imposes a fine against an individual, the individual shall not be indemnified by the community association.

COMMENT LETTERS

The letter writers support the general concept expressed in the proposed law, but offer specific suggestions for improvement. Some of those suggestions are very detailed (e.g., require that the bureau's website include a "Frequently Asked Questions" page). The staff recommends against that degree of control over bureau operations. Because we cannot accurately predict the bureau's workload or available resources, the bureau should be free to develop its own approach to implementing its duties under the law.

A few more general suggestions are discussed below.

Enforcement Jurisdiction

Type of Violation

The proposed law provides for bureau assistance in *mediating* a dispute involving CID law or a CID's governing documents. As presently drafted, the *enforcement* authority of the bureau would be narrower. It would only apply where there is a violation of "the law governing common interest developments." The bureau would not have authority to issue a citation or impose a penalty for violation of an association's governing documents.

Mr. Klein suggests that the bureau's enforcement jurisdiction should encompass enforcement of governing documents (see Exhibit pp. 3-4):

> It would be disappointing to many of us, and that is putting it mildly, if, aside from violations of the law, the avenues for relief would be left essentially just as they are, which seems to be the case with the legislation as drafted.
>
> …

> But then major problem areas are left unresolved, and the abusive conduct of some Association Boards will persist. This draft does not address the problem in its entirety.
>
> Moreover, the argument you present for this legislation is, in significant part, the benefits of removing these cases from litigation and the courts, yet this legislation achieves very little in that regard for those cases where the dispute involves something other than violations of the law.

Mr. Klein is correct that many CID disputes will involve a violation of governing documents rather than a statutory violation. From a policy point of view, there will often be little difference between a violation of law and a violation of the governing documents. For example, Corporations Code Section 7512 provides a default rule for a quorum at a meeting of members of a nonprofit mutual benefit corporation: one-third of the voting power. A by-law may set a different quorum. Should bureau enforcement of a quorum rule depend on whether that rule is provided in the association's by-laws or in the statute? Also, many important substantive restrictions will be expressed only in the association's governing documents.

The staff's decision to draft the proposed law so as to limit the bureau's enforcement jurisdiction was based not on policy, but on legal concerns — concern that broader jurisdiction might violate constitutional limits on executive exercise of judicial powers.

The constitutional separation of powers doctrine limits the extent to which an executive branch agency may adjudicate a claim between two private parties. To survive a separation of powers challenge, an administrative adjudication scheme must pass a three part test: (1) it must be legislatively authorized, (2) it must be reasonably necessary to accomplish the agency's regulatory purposes, and (3) the administrative decision must be subject to pre-enforcement judicial review. See *McHugh v. Santa Monica Rent Control Board*, 49 Cal. 3d 348, 374-75, 261 Cal. Rptr. 318, 777 P.2d 91 (1989):

> [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, for example, we would not approve the Board's adjudication of a

> landlord's common law counterclaims (extraneous to the Board's regulatory functions) against a tenant. Such adjudication would (i) not reasonably effectuate the Board's regulatory purposes — ensuring enforcement of rent levels — and (ii) it would shift the Board's primary purpose from one of ensuring the enforcement of rent levels, to adjudicating a broad range of landlord-tenant disputes traditionally resolved in the courts.

The staff was concerned that administrative enforcement of an association's governing documents, independent of any statutory violation, would cross the line into adjudication of disputes that have traditionally been resolved by the courts.

The staff may have been too cautious in that regard. There is at least one example of an administrative agency with authority to adjudicate private contractual claims. The director of the Bureau of Marketing Enforcement ("director") has authority to license and regulate agricultural product processors. Under Food and Agricultural Code Section 55741, the director can investigate:

> (a) A transaction that involves the failure of the processor to make payment for any farm product within the time that is specified for payment in the contract of sale and purchase between the producer and the processor, in accordance with the terms of the contract or in accordance with this chapter.
>
> (b) A transaction that involves the failure of a processor who contracts to harvest a producer's crop to fulfill the terms of the contract.

Nonpayment on a purchase contract is defined as a violation of law:

> It is a violation of this chapter if the applicant, or licensee, has failed or refused to pay for any farm product at the time and in the manner which is specified in the contract with the producer, or is otherwise provided in this chapter.

Food & Agric. Code § 55872. Such a violation is grounds for suspension or revocation of the processor's license to do business. The director may also impose terms of probation, which can include a requirement that the processor pay the amount owed. Food & Agric. Code §§ 55524, 55525.75. Before taking disciplinary action, the director must provide notice and an opportunity for an administrative appeal. Food & Agric. Code § 55528.

The constitutionality of this scheme was asserted, in dicta, in *McKee v. Bell-Carter Olive Co.*, 186 Cal. App. 3d 1230, 231 Cal. Rptr. 304 (1988), and has not been

tested since. Thus, it appears that some degree of administrative enforcement of a private agreement may be constitutionally permissible.

Considering the obvious benefit of bureau assistance in resolving a dispute that involves an association's governing documents, it may make sense to revise the proposed law to allow for agency enforcement of governing documents. Should proposed Section 1380.310 be revised along the following lines?

> **§ 1380.310. Violation of law**
>
> 1380.310. (a) If the bureau learns of a probable violation of the law governing common interest developments or of a common interest development's governing documents it may attempt to remedy the violation informally, as provided in Section 1380.300.
>
> (b) If the bureau finds that a violation has occurred and that it cannot be remedied informally under Section 1380.300, the bureau may issue a citation by serving it on the person responsible for the violation. The citation shall cite the ~~statute or regulation~~ provision of law or of the governing documents that has been violated and the facts constituting the violation. The citation shall order abatement of the violation and may order additional equitable relief as appropriate. If the bureau finds, by clear and convincing evidence, that a violation involved malice, oppression, or fraud, as those terms are defined in Section 3294, the bureau may order removal of the violator from office within a community association.
>
> …

Persons Subject to Enforcement

If the bureau is limited to enforcing violations of law, it is also effectively limited to enforcement against an association. That is because the Davis-Stirling Common Interest Development Act and the Nonprofit Mutual Benefit Corporation Law impose duties almost exclusively on the homeowners association and its officers, and not on individual homeowner members.

If the bureau is given authority to enforce governing documents, that would open the door to enforcement against homeowners, whether initiated by the association or by another homeowner. Should such actions be authorized?

One of the justifications for state intervention in CID disputes is the disparity of resources that exists between a homeowners association and its individual members. An association is much better able to bear the cost of litigation than an individual homeowner. Bureau enforcement against an association would level the playing field, by providing a low-cost forum for vindication of homeowner rights. An association would benefit from, but does not require, such assistance.

Considering the possibility that the bureau's enforcement resources will be stretched thin, it might make sense to limit the bureau to investigating and correcting association violations. Thus:

> **§ 1380.310. Violation of law**
>
> 1380.310. (a) If the bureau learns of a probable violation by an association or a director or officer of an association, of the law governing common interest developments or of a common interest development's governing documents it may attempt to remedy the violation informally, as provided in Section 1380.300.
>
> …

Retroactive Application and Limitations Period

The proposed law does not address whether the bureau would have authority to adjudicate violations that occurred before the bureau's creation. Mr. Klein suggests that the bureau should be able to do so. The staff is not aware of any legal constraint that would require the bureau's jurisdiction to be prospective only. In general, revisions to remedial and procedural provisions may be given retrospective effect so long as the changes do not affect substantive rights.

As a practical matter, the bureau is likely to have its hands full with prospective cases. The workload resulting from past violations might be overwhelming. On the other hand, most of the homeowners contacting the bureau in its first year will probably be concerned about problems that arose before the bureau's creation. Denying homeowners help with those cases could produce a lot of dissatisfaction.

Should the bureau have such authority (subject to any applicable statute of limitations)?

On the subject of applicable limitations periods, it might be helpful to expressly limit the bureau's enforcement authority to investigations commenced within any applicable limitations period. Comment language could be added with cross-references to relevant time limitation provisions.

Indemnification

The proposed law provides that an association may not indemnify a director or officer who is personally subject to a monetary penalty. Mr. Klein suggests that the proposed law should also prohibit indemnification of legal expenses. While the staff did not have expenses in mind when drafting the indemnification language, the language is compatible with Mr. Klein's suggestion.

In general, a corporate agent can be indemnified for legal expenses. See Corporations Code Section 7237, which authorizes a nonprofit mutual benefit corporation to indemnify an agent for "expenses, judgments, fines, settlements and other amounts actually and reasonably incurred in connection with such proceeding." For the sake of clarity, we might wish to use similar language in the proposed law. Also, the staff believes it was a mistake to limit the indemnification prohibition to cases where a fine is imposed. Under the proposed law, a finding of malice, oppression, or fraud is also grounds for removal from office. Indemnification should be prohibited in any case in which the bureau determines a director's or officer's actions involved malice, oppression, or fraud. *Cf.* Corp. Code § 7237 (authorizing indemnification only in cases of good faith).

The staff recommends that the last sentence of proposed Section 1380.310(c) be stricken and a new subdivision (f) added to the section, as follows:

> (f) If the bureau finds, by clear and convincing evidence, that a violation involves malice, oppression, or fraud, as those terms are defined in Section 3294, and that finding is not contested or is upheld after administrative and judicial review, the person found responsible for the violation shall be deemed to have acted in bad faith and the association shall not indemnify the person for any expenses, judgments, fines, settlements or other amounts incurred in connection with the proceedings.

Even if indemnification is prohibited, that would not necessarily preclude reimbursement of expenses and fines from an association's directors and officers liability insurance. That is the reason for the draft language declaring that the violator acted in bad faith. The staff believes that D&O insurance would typically not cover a claim involving bad faith.

Period of Removal from Office

The proposed law would allow the bureau to order that an association director or officer be removed from office in cases of extreme misconduct. Should the law mandate a period of time following removal in which that person is barred from returning to office? The staff is inclined to leave such details to administrative development.

Definition of "Violation" for Purposes of Calculating Penalty Amount

Under the proposed law an administrative fine may not exceed $1,000 per violation. Should the meaning of "violation" be defined for the purpose of that

rule? For example, if a board unlawfully refuses member access to records on three separate dates, would that be three violations or one? This should probably be addressed. If the Commission agrees, the staff will add a definition to the proposed law that is consistent with the prevailing approach in analogous regulatory provisions.

Respectfully submitted,

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Re: CLRC Memorandum 2004-39

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Mr. Sterling, August 16, 2004

I heartily applaud the CLRC staff's efforts as reflected in MM04-39 to create a CID oversight Bureau. To promote acceptance of the Bureau I have some suggestions. Please accept them in the spirit of encouragement - as they are intended.

Since it would be a new entity, it should initially be headed by a single executive officer, thereby enabling rapid adjustment to conditions as they arise. However, the wisdom and talent of the first executive officer and staff will be crucial to the success of the Bureau.

The Bureau should appear neutral between homeowners and board members but strongly on the side of the association as a whole. It should often repeat the concept that an HOA is actually a 'club' of homeowners that have one major common interest - the success of their community.

As noted there would be a website with the informational brochures, some intended for homeowners and some for board members. But in addition I suggest a Frequently Asked Questions (FAQs) page. The FAQs could have questions on a wide range of subjects and answers from several sources.

The Bureau should provide additional resources to association board members. Board members are volunteers, have no training, and a personal life that always has priority. The Bureau's website could be an outstanding resource to board members. There could be a 'chat room' to communicate with other board members, to compare vendor

costs and performance, problem resolution ideas, et cetera. There could also be articles on the positives and the pitfalls of being a board member.

In the area of Mediation the Bureau can provide the invaluable ingredient of discussion before a dispute gets beyond the point of calm resolution. Beyond that, if a homeowner refuses to discuss the dispute then the current legal procedures should continue. On the other hand, if the homeowner petitions the Bureau to review the dispute, then the board would be required to cooperate. After review, the Bureau would file a 'Friend of the Court' brief. This would appear to solve sever al current issues, it would be in the homeowner's (if a victim) best interest to cooperate, abusive boards would be identified, and responsible boards would be supported.

Not only must there be fair and just review of internal CID disputes, there must be a vision of how the CID concept must evolve. When CID law was first created, management companies were expected to help avoid the abuses that exist today, but that concept failed.

There must be expertise within the Bureau to understand and review an association's financial statements. Each association's latest budget and reserve study must be available to the Bureau on demand. This would reflect a level of importance and seriousness to the Bureau. (By the way, the financial matters - conceptually - of an association are much less complicated than of an average home, and certainly more predictable, so not a hard position to fill.)

I recommend a six year trial period to encompass three budget cycles.

I strongly support the Bureau being within the DCA for several reasons, the foremost being that each association is a consumer with a capital C!

As the number of homeowners living in a CID continues to grow, it is imperative that the CID structure in California change to meet the needs of homeowners, after all isn't that what HOAs are all about? Given the nature of humans, there will always be disputes and abuse. The State of California - to be a desirable state to live in - must reduce the current prevalence of abuse, minimize future opportunity to abuse, and promote a spirit of cooperation within HOAs. There is no long term alternative.

Bruce Osterberg

EMAIL SUBMISSION FROM MEL KLEIN (8/17/04)

RE CLRC Staff Recommendation MM04-39

1. I support the proposal that the agency would be able to deal with violations of the law, with or without mediation, as you noted in the memo you wrote to me.

   (That aspect of your proposal is a bit obscured by comments in the section **Law Enforcement Powers,** where the text: "and efforts to remedy the situation through mediation are unsuccessful, the bureau would have authority to issue a corrective citation." could be understood as meaning that it is only when mediation has been attempted and failed is the bureau so empowered.

   It is not terribly clear in the text of the legislation itself either.)

2. In 1380.310 you propose that in case of a violation of law, "a violator" may be removed from office if the violation involves malice, oppression or fraud. It seems to me that *any* misconduct that involves malice, oppression or fraud should subject the violator to removal from office; I do not see any reason at all for a distinction.

3. Does the fact that "the violator" might be a group of people, eg. the Board (majority), require any clarification in the text of 1380.310? Does the maximum fine of $1000 apply to the case or to each individual?

4. The draft does not address use of Corporate funds for costs and attorney's fees in support of a Board, and I think that may be a missed opportunity, because funding of disputes is a critical point of leverage. (What about fees paid to an attorney to represent the Board in a 1380.300 mediation? Where the violator is not to be reimbursed by the Association for an imposed fine, what about those attorney's fees?) I realize that you are trying to set up an agency, not in rewriting Davis Stirling, but the two could possibly be integrated (see below).

5. I agree that your recommendation that the agency be placed in the DCA is the right one. I initially recommended placing the agency in the Department of Justice, but I probably suffer from tunnel vision on the subject, because of the experiences I've had with the Board of our association.

6. What if an officer is removed by the Bureau, and shortly thereafter, the Board reinstates him? How long does such a disqualification last? It should be forever.

7. It would be disappointing to many of us, and that is putting it mildly, if, aside from violations of the law, the avenues for relief would be left essentially just as they are, which seems to be the case with the legislation as drafted.

   If I understand the considerations correctly, it comes out that way in some part because the CLRC staff feels that ordering a mandatory process is not in order at this point.

   But then major problem areas are left unresolved, and the abusive conduct of some Association Boards will persist. This draft does not address the problem in its entirety.

   Moreover, the argument you present for this legislation is, in significant part, the benefits of removing these cases from litigation and the courts, yet this legislation achieves very little in that regard for those cases where the dispute involves something other than violations of the law.

More than mandatory ADR is required; what really is needed is mandatory, binding, resolution, outside of the courts. It would be an awful pity to leave so much of this unresolved once again, leaving association members once again depending on the courts for relief, at enormous costs, and with so little prospect for relief.

(I am attaching a second file describing what occurred in our last Board election, so you can see the terrible things that can go on without violating any laws. It isn't required reading - I'm sure you have heard enough of these complaints for one lifetime - but ours is enormously shocking.)

8. If a case involving violation of the law is brought to traditional ADR, not to the bureau, and there is a determination that there has been a violation of the law, what about the fines and removal from office? Does the other party then appeal to the bureau for further relief?

   What if the ADR hearing officer (wrongly) determines that there has not been a violation of the law? Can the case still be brought to the bureau?

I feel that there is an asymmetry in the draft proposal in placing the new bureau at the same "level" as traditional ADR. They are not the same, even as drafted. They have different powers. They are just different.

I think many of the objections raised here would be answered by a simple rearrangement of the draft proposal, placing the bureau not as an alternative to traditional ADR, but as an alternative to the courts following ADR, or just below the courts if you like. That, after all, is a major objective of the Agency, to provide an alternative to litigation, not to provide an alternative to ADR.

Moreover, by leaving ADR just as it is (essentially), you avoid provoking a host of retired judges, who might rise up in arms at an arrangement they view as a threat to their livelihood.

Given this alternative hierarchy, with the bureau as an alternative *following* ADR, along with a few, eminently reasonable modifications to the draft as it now stands, many of the concerns listed above are dealt with to some extent.

- **Case 1: No ADR** If a party refuses ADR, and chooses instead to proceed directly to the Courts, then that party shall not be entitled to reimbursement of costs or attorney's fees from Association funds, except at the discretion of the Court at the conclusion of the lawsuit, when awarding costs and attorneys fees.

  A party refusing ADR would still be allowed to request binding arbitration before the bureau, thus avoiding Court costs and attorneys fees (unless the other party files the lawsuit.)

  > This is the most just of regulations. There is no reason that an Association should be burdened with the costs of an impetuous and reckless Board. The current rule allowing the Courts to take a refusal to participate in ADR into consideration in awarding costs and attorneys fees is not very useful, when those costs too are loaded onto the backs of shareholders.

- **Case 2: Unsuccessful ADR** The arbitrator/mediator in a Davis Stirling ADR that does not result in resolution shall henceforth be required to recommend at the close of the ADR

whether the case go on to the bureau for binding decision, or to the courts. Among the criteria to be considered would be:

a. Whether the costs of a lawsuit are a warranted burden on the shareholders
b. The preference of the party more forthcoming at the ADR (to encourage resolution at ADR)
c. The preference of the party with the more reasonable case at ADR

Where the recommendation is to proceed to the bureau, a party may still choose to go to the courts, but in that case the party shall be considered as having refused ADR; ref. Case 1.

This too is eminently just. There is no reason a Board should be entitled to squander shareholder funds when a hearing officer has determined that their case does not warrant a lawsuit.

There might have to be a full set of criteria written up for the ADR hearing officer to use in deciding whether to allow the case to go to Court at the expense of shareholders.

- **Case 3: Successful ADR** Where, in the view of the mediator/arbitrator, penalties might be in order, whether due to a violation of law or malice, fraud, or oppression, the mediator/arbitrator shall refer the case for review at the bureau to determine penalties. The judgment of the ADR hearing officer on the underlying issues shall be given due respect.

This would somewhat alleviate the burdens on the agency, by allowing an ADR hearing officer to handle more of the burden.

- **Direct Appeals to the Bureau** Complaints alleging violation of the law may also be brought directly to the bureau.

This approach - or some variation of it - makes ADR "semi-mandatory" so to speak, in that it allows a party to proceed to court if they choose, but if they do so choose, it could very well be on their own dime.

Rephrasing the same thought, under this variation of the draft proposal, no one is mandated to go to ADR, no one is mandated to appear before the bureau (except possibly under the circumstances you too mandate ie. violations of the law), no one is forced to do anything. The only consequence of going on your own to court, is that you are on your own insofar as the expenses of a lawsuit are concerned, and even those can be reimbursed by the Court.

Moreover, it positions ADR to play a more significant role in disputes, and not only promotes ADR, but promotes resolution within ADR. This will please the ADR judges, and align them with CLRC in seeing this legislation through.

Best of all, the entire spectrum of Association disputes is covered. That seems to me an absolute requirement in any legislation, that "all" problem areas be addressed, however that is achieved.

Someone would still have to think through this carefully, to see that there are not any unintended consequences.

I now realize that there remains a problem even under this scheme, in that persons who cannot afford a lawsuit are deprived of relief. It doesn't completely protect them that a Board would have to personally front money for their side of a lawsuit.

It would be nice if the Bureau would provide Court representation under certain conditions, when the other party refuses ADR, either initially, or when referred to the bureau by ADR.

It would be extremely useful if the powers of the Bureau to issue citations for violations of the law, and to disqualify persons who have engaged in such violations with malice… would apply to violations committed prior to the time the law goes into effect. There is no reason a person committing such violations currently should be allowed to serve once this law goes into effect, just because the person ceased the violations when threatened by the new law.

EMAIL SUBMISSION FROM MEL KLEIN (8/20/04)

RE CLRC Staff Recommendation MM04-39
August 20, 2004

1. In the section of your report **Empirical Data** you write about collecting "data on the nature and incidence of CID disputes in California". You might want to require ADR hearing officers to submit some form of report when they hear an ADR dispute.

2. In the section titled *Coordination with Existing ADR Requirements* you observe: "That would eliminate an existing problem: a person who wishes to avoid ADR can offer a form that the other party is likely to reject."

   Another way to avoid that problem is to require the party requesting resolution of a dispute offer multiple forms of ADR to choose from (at least one of them non-binding).

3. Absent a change such as that suggested in item 2., one of the proposals I made in the previous set of comments I submitted would have to be corrected:

- **Case 1: No ADR** If a party refuses **[an offer of non-binding]** ADR, and chooses instead to proceed directly to the Courts…

EMAIL SUBMISSION FROM MEL KLEIN (8/24/04)

RE CLRC Staff Recommendation MM04-39
August 24, 2004

I think the proposal I made should have another clause. In place of:

- **Direct Appeals to the Bureau** Complaints alleging violation of the law may also be brought directly to the bureau.

substitute:

- **Direct Appeals** A dispute may be brought directly to the Courts or to the bureau, without penalty to either party, if the parties agree in writing to do so.

  Complaints alleging violation of the law may also be brought directly to the bureau.

This is provided so that if the parties wish to avoid the expense of ADR as well, they should have the means to do so.

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Re: CLRC Memorandum 2004-39

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Mr. Sterling,

September 8, 2004

As a supplement to my letter of August 16 regarding creating a CID oversight Bureau I enclose some excerpts from correspondence between a homeowner and a management company representative that I recently became aware of. The excerpts are accurate and of course anecdotal.

The situation is that the homeowner is concerned that Reserves are being used for landscaping improvements at the expense of building painting. The homeowner is financially limited but is trying to alert neighbors of his concerns. The last three association presidents have bought-sold in short time periods.

With current law these future events are very likely:
1. The buildings continue to deteriorate.
2. A homeowner sells his property at a loss.
3. Homeowner sues the Association to recover his loss citing inadequate maintenance.
4. The lawsuit is successful, a settlement is awarded and paid by the association's insurance company (the management company escapes for legal reasons).
5. Remaining homeowners pay increased assessments for increased insurance costs and are left with significantly reduced property values.

This is just one example of the current abuses by short-term owners (for obvious reasons) and property managers (for peculiar reasons). It illuminates how the current system is broken and the need for an oversight agency with muscle.

Bruce Osterberg

EMAIL SUBMISSION FROM MEL KLEIN (9/13/04)

RE CLRC Staff Recommendation MM04-39

September 13, 2004

The proposed staff recommendation provides a vastly improved means of dealing with violations of law. More than that, the very existence of a means of recourse will change the behavior of association boards, so that such violations will be far less likely to occur.

What is missing is a means of dealing with very serious abuses that are not, prima facie, violations of law. The most egregious of these are violations of election fairness, and this is something that simply must be dealt with. It is the ultimate means of dealing with all the other abuses that are not violations of law; shareholders can remove the Board. This cannot be denied to shareholders in any purported reform of association law.

Here is what I believe is a simple, reasonable and just amendment to your recommendation. Just give one added power to your agency, as follows:

> Upon petition of any shareholder(s) in an association, the Agency may order a "Monitored Election" (or more broadly, a monitored vote) under conditions such as the following:
>
> 1) Appointment by the agency of an election (vote) Monitor, responsible for all decisions and arrangements for the election (vote), and service as Inspector of Elections.
>
> 2) Appointment by the agency of a CPA firm to serve as tabulators.
>
> 3) The same CPA firm would be required to store and hold confidential the election records for a period of "x" years.
>
> 4) The only authorized proxy holder would be the CPA firm. Shareholders wishing to vote by proxy would be required to send the proxy directly to the CPA firm.
>
> 5) The expenses of a monitored election shall be shared equally between the association and the petitioning party.

Items 3 and 4 are proposed to eliminate the intimidation factor from these votes. Legislators must realize that shareholders in associations are different than shareholders in other Corporations, in that they are subject to all forms of pressure from the Management and the Board, because the shareholder lives under the control of these officials.