

Second Supplement to Memorandum 2007-24

Statutory Clarification and Simplification of CID Law (Preliminary Part)

The attachment to this memorandum is a staff draft of the narrative “preliminary part” for the proposed reorganization of the Davis-Stirling Common Interest Development Act.

The preliminary part would be combined with the proposed legislation (attached to Memorandum 2007-24) and the conforming revisions (attached to the First Supplement to Memorandum 2007-24) to form a tentative recommendation. Once approved, the tentative recommendation would be circulated for public comment.

The staff proposes a comment deadline of September 21, 2007. That would leave the staff sufficient time to analyze public comments for presentation at the Commission’s October meeting.

The preliminary part is drafted to highlight those areas where the proposed law would make significant changes from existing law. Parts of the proposed law that would continue existing law without change are not described.

Respectfully submitted,

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Executive Secretary

CALIFORNIA LAW REVISION COMMISSION

STAFF DRAFT

TENTATIVE RECOMMENDATION

Statutory Clarification and Simplification of CID Law

June 2007

The purpose of this tentative recommendation is to solicit public comment on the Commission's tentative conclusions. A comment submitted to the Commission will be part of the public record. The Commission will consider the comment at a public meeting when the Commission determines what, if any, recommendation it will make to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made to it.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN September 21, 2007.

The Commission will often substantially revise a proposal in response to comment it receives. Thus this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

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SUMMARY OF TENTATIVE RECOMMENDATION

The Law Revision Commission recommends that the existing Davis-Stirling Common Interest Development Act be repealed and replaced with a new statute that continues the substance of existing law in a more user-friendly form.

The new statute would provide the following advantages for homeowners who must read, understand, and apply the law governing CIDs:

- (1) Related provisions would be grouped together in a logical order. This would make relevant law easier to find and use. It would also provide a logical organization for any future changes in the law.
- (2) Where there is significant overlap between the Corporations Code and the Davis-Stirling Act, the substance of the Corporations Code would be added to the Davis-Stirling Act and the Corporations Code provision would be made expressly inapplicable. This would consolidate relevant law in one location and minimize inconsistencies between the two sources of law.
- (3) Sections that are excessively long or complex would be restated in simpler and shorter sections.
- (4) Consistent terminology would be used throughout.
- (5) Some governance procedures would be standardized so as to simplify routine matters.
- (6) Various minor substantive improvements would be made.

This recommendation was prepared pursuant to Resolution Chapter 1 of the Statutes of 2006.

STATUTORY CLARIFICATION AND SIMPLIFICATION OF CID LAW

BACKGROUND

1
2 A common interest development (“CID”) is a housing development
3 characterized by (1) separate ownership of dwelling space (or a right of exclusive
4 occupancy) coupled with an undivided interest in common property, (2)
5 covenants, conditions, and restrictions that limit use of both the common area and
6 separate ownership interests, and (3) management of common property and
7 enforcement of restrictions by a community association. CIDs include
8 condominiums, community apartment projects, housing cooperatives, and planned
9 unit developments.¹

10 There are over 41,000 CIDs in California, ranging in size from three to 27,000
11 units each.² These developments comprise over four million total housing units.³
12 Most CIDs are relatively small, with over half consisting of 25 or fewer separate
13 interests.⁴

14 Homeowner associations are run by volunteer directors who may have little or
15 no prior experience in managing real property, governing a nonprofit association
16 or corporation, complying with the laws regulating CIDs, and interpreting and
17 enforcing the restrictions and rules imposed by the governing documents of an
18 association.⁵

19 Association management is made more difficult by the complexity of the law
20 that governs CIDs. The governing law has two main sources, which overlap and
21 are not entirely consistent with one another:

- 22 • *The Corporations Code*. If an association is incorporated, it is governed by
23 the Nonprofit Mutual Benefit Corporation Law.⁶ An unincorporated
24 homeowner association is subject to both the general law on unincorporated
25 associations,⁷ and specific provisions of the Nonprofit Mutual Benefit
26 Corporation Law.⁸

1. See Civ. Code § 1351.

2. Levy & Co., 2005 California Community Association Statistics 1 (2005).

3. *Id.*

4. Over two-thirds of associations have 50 separate interests or fewer. *Id.*

5. Many associations contract for professional management, accounting, and legal assistance. However, most associations are small and may not be able to afford those services. See *supra* note 4.

6. Corp. Code § 7110 *et seq.*

7. Corp. Code § 18000 *et seq.*

8. Specific provisions of the Corporations Code are applied to an unincorporated homeowner association by Civil Code Sections 1355.5, 1357.140, 1363, 1363.03, 1363.5, 1365.2, 1365.5, 1365.6, 1366, 1367.1, and 1369.590.

- 1 • *The Davis-Stirling Common Interest Development Act* (hereafter the “Davis-
2 *Stirling Act*”).⁹ That act provides a body of law specific to CIDs.

3 In order to determine what law applies to a particular issue, a CID homeowner
4 must read both sources of law together and attempt to resolve any inconsistencies
5 between the two.

6 OVERVIEW OF PROPOSED LAW

7 The Law Revision Commission recommends that the existing Davis-Stirling Act
8 be repealed and replaced with a new statute that continues the substance of
9 existing law in a more user-friendly form.

10 The proposed law would provide the following advantages for homeowners who
11 must read, understand, and apply the law governing CIDs:

- 12 (1) Related provisions would be grouped together in a logical order. This would
13 make relevant law easier to find and use. It would also provide a logical
14 organization for any future changes in the law.¹⁰
- 15 (2) Where there is significant overlap between the Corporations Code and the
16 Davis-Stirling Act, the substance of the Corporations Code would be added
17 to the Davis-Stirling Act and the Corporations Code provision would be
18 made expressly inapplicable. This would consolidate relevant law in one
19 location and minimize inconsistencies between the two sources of law.
- 20 (3) Sections that are excessively long or complex would be restated in simpler
21 and shorter sections.
- 22 (4) Consistent terminology would be used throughout.
- 23 (5) Some governance procedures would be standardized so as to simplify
24 routine matters.
- 25 (6) Various minor substantive improvements would be made.

26 For the most part, this is a nonsubstantive reform. However, there are a number
27 of instances where minor substantive improvements are proposed. Those changes
28 are discussed more fully below.

29 The “proposed law” part of this tentative recommendation also includes a
30 number of “notes” that invite public comment on specific issues.

31 A table following the proposed law shows the proposed location of each affected
32 provision of the Davis-Stirling Act.

9. Civ. Code §§ 1350-1378

10. One of the sources of the complexity of the Davis-Stirling Act is the lack of a coherent organizational structure. As changes are made to the law, it is not clear where to add new provisions, which perpetuates the lack of organization. That problem was partially addressed by the addition of chapter and article headings. See *Organization of Davis-Stirling Common Interest Development Act*, 33 Cal. L. Revision Comm’n Reports 1 (2003); 2003 Cal. Stat. ch. 557.

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GENERAL PROVISIONS

The proposed law would include a chapter of general provisions (i.e., provisions that apply to the act as a whole).¹¹ The general provisions include rules governing the application of the Davis-Stirling Act and the Corporations Code, (2) procedures used to deliver notices, and (3) definitions for commonly used terms. For the most part, those provisions would continue existing law. Any significant changes to existing law are discussed below.

Application of Davis-Stirling Act and Corporations Code

Nonresidential CIDs

Under existing law, an entirely nonresidential CID is exempt from specified requirements of the Davis-Stirling Act, on the grounds that those requirements “may not be necessary to protect purchasers in commercial or industrial developments” and could simply add unnecessary costs and burdens.¹²

The proposed law continues that exemption without change, except that a nonresidential CID would also be exempt from the member election provisions of the Davis-Stirling Act.¹³ Such an association would instead be governed by the Corporations Code member election procedures.¹⁴

Corporations Code

Proposed Civil Code Section 4025 is new. It would define the relationship between the Corporations Code and the Davis-Stirling Act, in two ways:

- (1) It would make clear that where there is an inconsistency between the two sources of law, the Davis-Stirling Act prevails.
- (2) It would list specific provisions of the Corporations Code that are entirely superseded by the Davis-Stirling Act. Those provisions reflect subjects where the substance of applicable Corporations Code provisions would be imported into the Davis-Stirling Act. Readers would no longer need to consult the Corporations Code on those matters.

Notice Procedures

Drawing from existing law, the proposed law would standardize the procedure for the delivery of various statutory notices.

11. See proposed Chapter 1 (commencing with Section 4000) of Part 5 of Division 4 of the Civil Code.

12. Civ. Code § 1373.

13. See proposed Civ. Code § 4020(a)(3).

14. See Corp. Code § 7510 *et seq.*

1 **Method of Delivery**

2 The proposed law would recognize three classes of notices and would specify
3 the manner of delivery for each:

4 (1) “Individual notice” would be delivered individually to a specific named
5 person.¹⁵ Individual notice is appropriate where a member’s individual
6 property interests would be affected.

7 (2) “General notice” would be provided to all members and could be provided
8 by various forms of general publication.¹⁶ General notice would be less
9 costly than individual notice. It would be appropriate for matters of more
10 general interest, such as the time, place, and agenda for a pending board
11 meeting.¹⁷

12 (3) A notice that is to be “delivered to the board” would be delivered in the
13 manner specified.¹⁸ This would give greater certainty as to how to
14 communicate with the board regarding official matters.

15 **Proof of Notice and Delivery Failure**

16 The Corporations Code provides rules for proving delivery of notice of a
17 member meeting (by affidavit) and for handling failed delivery (e.g., a mailed
18 notice returned as undeliverable).¹⁹

19 The proposed law would generalize the substance of those provisions, with one
20 significant change.²⁰

21 The exception relates to undeliverable mail: under existing law, if a mailed
22 notice is returned as undeliverable, the corporation is excused from all future
23 notice delivery to that member, provided that the corporation keeps a copy of any
24 notices to that member for a year.

25 That rule makes sense in a typical nonprofit corporation, where a member could
26 live anywhere. If the member moves without giving a forwarding address, the
27 corporation has no way, short of conducting an investigation at its own expense, of
28 determining where to send notice to that member.

29 A CID is different. Each member necessarily owns a unit in the CID. That
30 provides a straightforward alternative. When a mailed notice is returned as
31 undeliverable, future notices should be delivered to the separate interest owned by
32 the member.²¹

15. See proposed Civ. Code § 4040. Individual delivery can be made electronically, if the recipient assents to that form of delivery.

16. See proposed Civ. Code § 4045.

17. See, e.g., proposed Civ. Code § 4520 (board meeting notice given by general notice, unless member requests individual notice).

18. See proposed Civ. Code § 4035.

19. Corp. Code § 7511(b).

20. See proposed Civ. Code §§ 4050(d) (proof of delivery by affidavit), 4055(a) (delivery failure).

21. See proposed Civ. Code § 4055.

1 Terminology

2 **Parenthetical Reference**

3 The Corporations Code defines certain common procedural requirements and
4 then invokes those requirements by use of a parenthetical reference. For example,
5 Corporations Code Section 7150(b) provides in part: “Bylaws may be adopted,
6 amended, or repealed by approval of the members (Section 5034)...” Section 5034
7 specifies the number of affirmative votes required in order for an action to be
8 “approved by the members.” That approach simplifies drafting and facilitates the
9 use of standardized rules for common procedures.

10 The proposed law takes a similar approach with regard to the rules on voting
11 thresholds²² and forms of notice delivery.²³

12 **“Common Interest Development” Defined**

13 The Davis-Stirling Act defines the term “common interest development” by
14 reference to the four specific types of CID:²⁴

15 “Common interest development” means any of the following:

- 16 (1) A community apartment project.
- 17 (2) A condominium project.
- 18 (3) A planned development.
- 19 (4) A stock cooperative.

20 That definition facilitates drafting, but it is not very informative. A person who
21 wants a general understanding of what is meant by “common interest
22 development” would need to compare the definitions of the four specific types of
23 CID, in order to determine what they have in common.²⁵ In addition, a person
24 would need to consider Civil Code Section 1352, which provides that a CID must
25 have common area.

26 The proposed law would include a definition of “common interest development”
27 that states all of the substantive elements that define the term.²⁶

28 **CID Types**

29 The four types of CID are distinguished primarily by the nature of the
30 homeowner’s interest in the common area and the nature of the homeowner’s
31 separate interest.

22. See proposed Civ. Code §§ 4050 (approved by board), 4055 (approved by majority of all members), 4060 (approved by quorum of majority of members).

23. See proposed Civ. Code §§ 4035 (“delivered to the board”), 4040 (individual notice), 4045 (general notice).

24. Civ. Code § 1351(c).

25. See Civ. Code § 1351(d) (“community apartment project”), (f) (“condominium project”), (k) (“planned development”), (m) (“stock cooperative”).

26. See proposed Civ. Code § 4100.

1 The proposed law restates the definitions of the different types of CIDs to
2 emphasize the essential differences.²⁷

3 **“Governing Documents” Defined**

4 Existing law defines the “governing documents” of an association as follows:²⁸

5 “Governing documents” means the declaration and any other documents, such
6 as bylaws, operating rules of the association, articles of incorporation, or articles
7 of association, which govern the operation of the common interest development or
8 association.

9 The open-ended reference to “any other documents ... which govern the
10 operation of the common interest development” is potentially problematic. It could
11 cause problems in some provisions that use the term “governing documents.”²⁹

12 In the interest of certainty, the proposed law would omit the open-ended element
13 of the general definition of “governing documents.”³⁰ Instead, the term would
14 mean the four named (and statutorily regulated) types of governing documents: the
15 declaration, articles, bylaws, and operating rules.

16 **“Member” v. “Owner”**

17 The Davis-Stirling Act uses the terms “member” and “owner” interchangeably,
18 with about the same frequency. Neither term is defined in the Act. The Nonprofit
19 Mutual Benefit Corporation Law uses “member” exclusively.

20 In the interest of consistency, the proposed law would use the term “member”
21 exclusively. It defines that term so as to preserve the ownership aspect.³¹

22 **ASSOCIATION GOVERNANCE**

23 The proposed law would include a chapter on the governance of an association
24 by its board and members.³² It would include provisions relating to board
25 meetings, member meetings, member elections, record inspection, record keeping,
26 annual reports, director conduct, managing agents, and government assistance. For
27 the most part, those provisions would continue existing law. Any significant
28 changes to existing law are discussed below.

27. See proposed Civ. Code §§ 4105 (“community apartment project”), 4125 (“condominium project”), 4175 (“planned development”), 4190 (“stock cooperative”).

28. Civ. Code § 1351(j).

29. For example, what is the scope of a provision that authorizes an association to adopt procedures in the “governing documents” (Civ. Code § 1355), or that conditions the application of a provision of law on whether or not the “governing documents” have been amended (Civ. Code § 1360.5), or that requires a seller to provide a copy of the “governing documents” to a prospective buyer (Civ. Code § 1368)?

30. See proposed Civ. Code § 4150.

31. See proposed Civ. Code § 4160.

32. See proposed Chapter 3 (commencing with Section 4400) of Part 5 of Division 4 of the Civil Code.

1 Board Meetings

2 The Davis-Stirling Act includes a provision entitled the “Common Interest
3 Development Open Meeting Act.”³³ Though much simpler than the state and local
4 government open meeting laws,³⁴ it borrows some language from those laws and
5 has a similar thrust.

6 The CID Open Meeting Act has the following effect:

- 7 (1) Require advance notice of a meeting of the association’s board.
- 8 (2) Guarantee a member’s right to appear and speak at a meeting of the board.
- 9 (3) Define which matters may be considered by the board in closed executive
10 session.
- 11 (4) Require the preparation and availability of board meeting minutes.

12 Those rules are continued in the proposed law³⁵ with a number of minor
13 improvements, which are discussed below.

14 **Definition of “Meeting”**

15 Existing law defines “meeting” as follows:³⁶

16 As used in this section, “meeting” includes any congregation of a majority of
17 the members of the board at the same time and place to hear, discuss, or deliberate
18 upon any item of business scheduled to be heard by the board, except those
19 matters that may be discussed in executive session.

20 The proposed law continues that definition, except that it would not limit the
21 definition of “meeting” to a gathering for the consideration of business “scheduled
22 to be heard by the board.”³⁷

23 Strictly read, that language could create an inappropriate loophole. A board
24 could argue that the open meeting requirements do not apply to a gathering of the
25 board to consider association business so long as the matters to be considered are
26 not scheduled in advance. That would be inconsistent with the transparency sought
27 by open meeting laws.

33. Civ. Code § 1363.05.

34. See Gov’t Code §§ 11120-11132 (Bagley-Keene Open Meeting Act); 54950-54963 (Ralph M. Brown Act)

35. See proposed Article 2 (commencing with proposed Section 4500) of Chapter 3 of Part 5 of Division 4 of the Civil Code.

36. Civ. Code § 1363.05(f).

37. See proposed Civ. Code § 4090 (“board meeting”).

1 **Committees**

2 A board of directors may form a committee to exercise powers delegated to it by
3 the board.³⁸ It is not clear that the existing open meeting requirements apply to
4 such a committee.

5 The proposed law would expressly apply the open meeting requires to a meeting
6 of a committee that exercises any power of the board.³⁹ If the law requires
7 openness when a board meets to exercise one of its powers, then openness should
8 also be required if the same power is exercised by a committee created by the
9 board.

10 **Inclusion of Agenda in Meeting Notice**

11 Existing CID law requires only that the time and place of a board meeting be
12 included in notice of the meeting.⁴⁰

13 Government open meeting law requires that a meeting notice also include an
14 agenda for the meeting.⁴¹ That is a sensible rule, which would add little expense.

15 The proposed law would apply the same requirement to a CID board meeting.⁴²

16 **Adjournment to Another Time and Place**

17 The Corporations Code provides for adjournment of a board meeting to another
18 time and place.⁴³ That provision would be continued in the proposed law.⁴⁴

19 If the meeting is adjourned for more than 24 hours, then notice of the time and
20 place at which the meeting will resume must be given to a director who was not
21 present at the time of adjournment.⁴⁵

22 The proposed law would also require that notice be given to members.⁴⁶

23 **Meeting Location**

24 Existing statutory law is silent on where a CID board meeting may be held. The
25 Department of Real Estate's regulations include a requirement that a board
26 meeting be held within the development, unless the available meeting space is too
27 small, in which case the meeting must be held as close to the development as is
28 practicable.⁴⁷

38. See Corp. Code §§ 7151(c)(4), 7212.

39. See proposed Civ. Code § 4560(a).

40. Civ. Code § 1363.05(g).

41. See Gov't Code §§ 11125(b), 54954.1-54954.2.

42. See proposed Civ. Code § 4520(a).

43. Corp. Code § Section 7211(a)(4).

44. See proposed Civ. Code § 4505(b).

45. Corp. Code § 7211(a)(4).

46. See proposed Civ. Code § 4520(d).

47. 10 Cal. Code Regs. § 2792.20(b).

1 The proposed law would codify that rule.⁴⁸

2 **Teleconference**

3 The Corporations Code specifically authorizes the use of teleconferencing in a
4 nonprofit mutual benefit corporation board meeting.⁴⁹ Government open meeting
5 laws also provide for teleconferencing.⁵⁰

6 The Davis-Stirling Act does not specifically address teleconferencing at a board
7 meeting. The existing definition of a meeting as “any congregation of a majority
8 of the members of the board *at the same time and place*”⁵¹ could preclude a
9 teleconference in some cases.

10 The proposed law authorizes the use of teleconferencing in board meetings.⁵² It
11 expressly provides that a director who participates in a meeting by teleconference
12 is deemed to be “present,” thus avoiding any conflict with the definitional
13 requirement that a majority of members be present in the same location. The
14 proposed law would also state basic procedural requirements that are drawn from
15 the teleconference provisions of the Corporations Code and the government open
16 meeting laws.

17 **Executive Session**

18 Although board meetings are generally open to the members of an association,
19 there are circumstances in which the board may meet privately, in closed
20 “executive session.”⁵³

21 Executive session is permitted when the board considers member discipline, an
22 assessment dispute, or a member request for an assessment payment plan.⁵⁴

23 A board must meet in closed executive session when the member who is the
24 subject of a disciplinary matter requests that the matter be closed.⁵⁵ Executive
25 session is also required when a board considers a request for a payment plan⁵⁶ or
26 votes to foreclose to enforce an assessment lien.⁵⁷

27 Under existing law, a member who is disputing an assessment debt does not
28 have the right to compel that the matter be discussed in executive session.
29 Arguably the same privacy considerations that apply to member discipline, a

48. See proposed Civ. Code § 4530.

49. Corp. Code § 7211(a)(6).

50. See Gov’t Code §§ 11123(b), 54953(b).

51. Civ. Code § 1363.05(f) (emphasis added).

52. See proposed Civ. Code § 4535.

53. Civ. Code § 1363.05(b).

54. *Id.*

55. *Id.*

56. Civ. Code § 1367.1(c)(3).

57. Civ. Code § 1367.4(c)(2)

1 payment plan request, or a decision to foreclose would also apply to consideration
2 of an assessment dispute.

3 The proposed law would require that an assessment dispute be considered in
4 closed executive session when requested by the member who raised the dispute.⁵⁸

5 **Board Action by Written Assent**

6 The Corporations Code allows the board to act without holding a meeting, if all
7 members of the board assent to the action in writing.⁵⁹

8 The Davis-Stirling Act does not specifically address board action by unanimous
9 written assent. However, the circulation of a written proposal to the directors for
10 their assent would not constitute a “meeting” and would therefore not trigger the
11 various open meeting requirements.

12 The proposed law would generalize the Corporations Code procedure so that it
13 applies to any homeowner association, whether incorporated or unincorporated.⁶⁰

14 **Member Meeting**

15 Existing law includes a number of provisions that regulate the conduct of a
16 meeting of the membership. Some are in the Davis-Stirling Act,⁶¹ others are in the
17 Corporations Code.⁶²

18 It would be easier for homeowners if all of the provisions relating to member
19 meetings were located in the Davis-Stirling Act. Such a change would have two
20 other benefits: (1) it would generalize the Corporations Code provisions so that
21 they also apply to an unincorporated homeowner association, and (2) it would
22 provide an opportunity to make minor improvements to procedures and drafting.

23 That is the approach taken in the proposed law.⁶³ Specific issues relating to the
24 proposed member meeting provisions are discussed below.

25 **Meeting Location**

26 The Corporations Code allows a member meeting to be held anywhere, provided
27 that the location is designated in the bylaws.⁶⁴ If no location is designated, the
28 meeting is to be held at the “principal executive office” of the corporation.

58. See proposed Civ. Code § 4540(b).

59. Corp. Code § 7211(b).

60. See proposed Civ. Code § 4545.

61. See Civ. Code §§ 1363(d) (parliamentary procedure), (e) (notice of matters to be considered).

62. See Corp. Code §§ 7510(a) (meeting place), (b) (meeting time), (c)-(d) (court ordered meeting), (e) (special meeting), (f) (electronic participation); 7511 (meeting notice); 7512 (quorum).

63. See proposed Civ. Code §§ 4575-4620. Those provisions would supersede the comparable Corporations Code provisions. See proposed Civ. Code § 4025(b)(2).

64. Corp. Code § 7510(a).

1 The proposed law would instead require that a member meeting be held in the
2 development, if space allows. If there is no suitable meeting space, then the
3 meeting is to be held as near to the development as is practicable.⁶⁵ That would
4 parallel the rule proposed for board meetings.⁶⁶

5 The proposed rule would work well in an association that is comprised mostly of
6 primary residences. It would work less well in an association in which the units
7 are primarily second homes (e.g., a condominium complex in a resort area).
8 However, in such a case it is unlikely that any single meeting location would be
9 convenient to all members. A meeting in the development itself would at least be
10 convenient to those members who are resident year-round.

11 Note too that a CID with a scattered member population could use a mailed
12 ballot in lieu of a meeting⁶⁷ or could use teleconferencing to provide satellite
13 locations for participation in the meeting.⁶⁸

14 **Teleconference**

15 The Corporations Code authorizes the use of teleconferencing in conducting a
16 member meeting.⁶⁹ The proposed law continues that policy,⁷⁰ but it does so with
17 language that is drawn from the proposed board meeting teleconferencing
18 provision.⁷¹ Use of the same standards for both types of meetings should simplify
19 compliance with the law.

20 Member Elections

21 **Election Rules**

22 Existing law requires that an association adopt operating rules to address certain
23 aspects of member election procedure.⁷² The proposed law would continue that
24 requirement but would allow the election rules to be expressed in any type of
25 “governing document.”⁷³ That would allow for the election rules to be stated in the
26 declaration, bylaws, articles, or operating rules.⁷⁴

27 That flexibility would reduce the administrative burden on an association that
28 already provides sufficient election rules in its governing documents. To require

65. See proposed Civ. Code § 4575(c).

66. See proposed Civ. Code § 4530; 10 Cal. Code Regs. § 2792.20(b).

67. See proposed Civ. Code § 4640.

68. See proposed Civ. Code § 4590.

69. Corp. Code § 7510(f).

70. See proposed Civ. Code § 4590.

71. See proposed Civ. Code § 4535.

72. Civ. Code § 1363.03(a).

73. See proposed Civ. Code § 4630.

74. See proposed Civ. Code § 4150.

1 that existing rules be restated as operating rules would add costs without any
2 benefit.⁷⁵

3 **County Model**

4 Existing law provides that an association “shall use as a model those procedures
5 used by California counties for ensuring confidentiality of voter absentee
6 ballots....”⁷⁶

7 That requirement is problematic. There appears to be no single statewide
8 standard that can serve as a model. Instead, the election official in each county
9 seems to be charged with developing local procedures to preserve the
10 confidentiality of absentee ballots.⁷⁷ That raises the question of which counties
11 should be used as a model? And how many counties?

12 Furthermore, existing law provides detailed election procedures. It is unclear
13 that any meaningful gaps remain to be filled with procedures that are modeled on
14 county election procedures.

15 The proposed law does not continue the “county model” requirement.

16 **Sealed Ballot Voting Procedure**

17 Existing law provides a detailed mandatory procedure for the use of sealed
18 ballots in certain types of elections.⁷⁸ The proposed law would continue that
19 procedure, with the same scope of application.⁷⁹

20 Under that procedure, an anonymous ballot is sealed within an anonymous
21 envelope. That envelope is then sealed within a mailing envelope, on which the
22 identity of the member is printed.

23 The member’s identity and voting rights are determined from the outside
24 envelope. The inside envelope is extracted and set aside for eventual counting of
25 the enclosed ballot. The anonymity of the ballot is preserved.

26 Vote counting is to be conducted at a properly noticed board or member
27 meeting, which must be open to the public. Any member has the right to observe
28 the process of ballot counting.⁸⁰ This guarantee of transparency is in tension with
29 the secrecy of the balloting process, and it is not entirely clear how the two goals
30 are reconciled in practice.

75. An operating rule may not contradict the declaration, articles, or bylaws. See proposed Civ. Code § 6100(c). Therefore, any operating rule cannot be used to change an election rule from what is already stated in those other types of governing documents. Therefore, if an association already has election rules in place in the declaration, articles, or bylaws, there would be no purpose in requiring that the operating rules also include election rules, as they could not differ from the existing rules.

76. Civ. Code § 1363.03(e).

77. See Elec. Code § 3017(b).

78. Civ. Code § 1363.03(b).

79. See proposed Civ. Code § 4640.

80. See proposed Civ. Code §§ 4650-4655.

1 The proposed law adds a minor clarification on that point:

2 Any member may observe the counting of ballots, but shall not be permitted to
3 observe any information that would reveal the identity of a member casting a
4 ballot.⁸¹

5 **In-Person Voting Procedure**

6 The existing sealed ballot procedure is expressly modeled after the absentee
7 ballot procedure used in public elections.⁸² The complexity of the procedure makes
8 sense in that context. The person who receives a mailed ballot needs to verify the
9 identity and eligibility of the member without being able to see how the member
10 voted.

11 Ballot secrecy is easier to achieve when a vote is cast in person. The election
12 inspector can verify the voter's identity and eligibility face to face and then
13 provide the member with a blank ballot. The member can mark the ballot
14 privately, and place it in a sealed ballot box.

15 The proposed law includes a procedure along those lines for an election that is
16 conducted in person, rather than by mail.⁸³ That would be a significant
17 simplification.

18 **Cumulative Voting**

19 The governing documents of an association may require that directors be elected
20 using cumulative voting. Cumulative voting is a system in which each voter may
21 cast a number of votes equal to the number of seats to be filled. For example, if
22 there are three vacancies being filled, a member could cast three votes. Those
23 votes can be combined in any fashion. All three could be cast for one candidate;
24 two votes could be cast for one candidate and one vote for another; etc. The
25 candidates who receive the highest vote totals fill the vacant seats.⁸⁴

26 The Corporations Code provides that cumulative voting may only be used if at
27 least one member gives notice of an intention to use cumulative voting, at the
28 member meeting that precedes the election.⁸⁵ That requirement could be difficult
29 to satisfy if an association decides to forego most member meetings in favor of
30 conducting elections entirely by mail (as existing law allows). It could also
31 unfairly advantage candidates who have advance notice that cumulative voting
32 will be used and plan their campaigns accordingly.

81. See proposed Civ. Code § 4650(c).

82. Civ. Code § 1363.03(e).

83. See proposed Civ. Code § 4645.

84. Corp. Code § 7615.

85. Corp. Code § 7615(b).

1 The proposed law would supersede the existing limitation. Instead, cumulative
2 voting would be mandatory in any association that permits cumulative voting.⁸⁶
3 That approach would provide less flexibility but would be simple and predictable.

4 **Teleconference**

5 The proposed law would permit the use of teleconferencing at a member
6 meeting.⁸⁷ As a practical necessity, a member who participates in a meeting by
7 teleconference would be required to vote orally. That special rule would supersede
8 the sealed ballot procedure.⁸⁸

9 **Campaign Activity**

10 Both the Davis-Stirling Act and the Corporations Code include provisions that
11 govern the use of association resources in campaign activity. The general principal
12 is that an association resource may not be used for campaign advocacy unless
13 equal access to the resource is provided to all advocates or candidates.⁸⁹

14 The proposed law continues those rules, with minor improvements to clarity and
15 consistency.⁹⁰

16 A provision drawn from the Corporations Code is included in the proposed law,
17 to make clear that an association is not liable for the publication of information
18 that the association is required to publish pursuant to the equal access rules.⁹¹

19 **Voting Rights**

20 The Davis-Stirling Act is generally silent on the number of votes that a member
21 may cast if the member owns more than one separate interest or shares ownership
22 of a separate interest with other members.

23 The proposed law includes default rules on those issues,⁹² which are drawn from
24 the Corporations Code⁹³ and the Department of Real Estate's regulations.⁹⁴

25 **Action by Written Consent**

26 Under the Corporations Code, any action that requires the approval of the
27 members may be approved by the unanimous written consent of the members.⁹⁵

86. See proposed Civ. Code § 4640(f).

87. See proposed Section 4590.

88. *Id.*

89. Civ. Code §§ 1363.03(a)(1)-2, 1363.04.

90. See proposed Civ. Code §4670.

91. See Corp. Code § 7525; proposed Civ. Code §4670(b).

92. See proposed Civ. Code § 4675.

93. Corp. Code §§ 7312(d), 7611(a).

94. 10 Cal. Code Regs. § 2792.18.

95. Corp. Code § 7516.

1 This provides a useful alternative where a proposal is entirely uncontroversial. The
2 proposed law would include the same rule.⁹⁶

3 Suppose that an association wishes to amend a bylaw in a way that is acceptable
4 to every member of the association. The proposed law would allow those members
5 to make the amendment by simply signing a document assenting to the change.
6 The complex procedures for notification of a member meeting, sealed ballots, the
7 hiring of an election inspector, and ballot counting at an open meeting could be
8 avoided.

9 **Judicial Enforcement**

10 The Corporations Code⁹⁷ and the Davis-Stirling Act⁹⁸ provide different and
11 inconsistent rules for judicial enforcement of the member election laws.

12 The proposed law would continue the Davis-Stirling Act provision⁹⁹ and state
13 expressly that the Corporations Code provision is inapplicable.¹⁰⁰ That will help to
14 avoid uncertainty as to which law controls.

15 **Inspection of Records**

16 An important check on association power is a member's right to inspect
17 association records. This allows a member to monitor how the association's
18 elected representatives are discharging their duties and spending association
19 money.

20 **Existing Law**

21 Until recently, record inspection rights were addressed exclusively by the
22 Corporations Code.¹⁰¹ It provides for member access to the membership list and
23 "accounting books and records" of the association, as well as minutes of meetings.
24 The right to inspect the membership list is limited to a noncommercial use of the
25 list that is reasonably related to the member's interest as a member.¹⁰² Inspection
26 may be limited in order to protect members' privacy rights.¹⁰³ The inspection right
27 can be enforced in the superior court.¹⁰⁴ Costs and expenses, including reasonable

96. See proposed Civ. Code § 4680.

97. Corp. Code § 7616.

98. Civ. Code § 1363.09.

99. See proposed Civ. Code § 4685.

100. See proposed Civ. Code § 4025(a)(3).

101. See Corp. Code §§ 8330-8338.

102. Corp. Code § 8338.

103. Corp. Code § 8332.

104. Corp. Code § 8336.

1 attorney’s fees, may be awarded to the member if the association acted unlawfully
2 in denying inspection.¹⁰⁵

3 The Davis-Stirling Act expressly incorporates those provisions.¹⁰⁶ As a result,
4 they apply to any association, even one that is unincorporated.

5 In 2003, the Legislature added Civil Code Section 1365.2 to further elaborate on
6 CID member record inspection rights.¹⁰⁷ That section was repealed and replaced
7 with another section of the same number in 2005.¹⁰⁸ The new section added
8 additional record inspection rules.

9 The proposed law continues existing law on member record inspection rights,
10 except as discussed below.¹⁰⁹

11 **Preemption of Corporations Code**

12 The Corporations Code provisions on record inspection are expressly applicable
13 to a CID.¹¹⁰ However, the main Davis-Stirling Act provision on record inspection
14 states that it supersedes two of those Corporations Code provisions, to the extent
15 of any inconsistency with those sections.¹¹¹

16 Those rules of application are potentially confusing. There is a high degree of
17 overlap between the Davis-Stirling Act and the Nonprofit Mutual Benefit
18 Corporation Law, combined with some uncertainty as to which provisions of the
19 Corporations Code are superseded as “inconsistent” with the Davis-Stirling Act.

20 The proposed law would completely preempt the Corporations Code provisions
21 on record inspection.¹¹² This would provide a single clear source of law on the
22 topic. It should not result in significant substantive change in the law, as most of
23 the substance of the Corporations Code provisions is also addressed by the Davis-
24 Stirling Act.

25 **Scope of Inspection Right**

26 The proposed law would broaden the scope of the member record inspection
27 right to include two new types of records:

- 28 (1) The “governing documents” of the association and “any other document that
29 governs the operation of the common interest development or its
30 association.”¹¹³

105. Corp. Code § 8337.

106. See Civ. Code § 1363(f).

107. 2003 Cal. Stat. ch. 375.

108. 2005 Cal. Stat. ch. 458.

109. See proposed Civ. Code §§ 4700-4750.

110. Civ. Code § 1363(f).

111. Civ. Code § 1365.2(m).

112. See proposed Civ. Code § 4025(a)(4).

113. See proposed Civ. Code § 4700(a)(1).

1 (2) “Written correspondence of the association, other than correspondence that
2 relates to personnel matters, member discipline, an assessment dispute or a
3 request for a payment plan for overdue assessments.”¹¹⁴

4 The listed exceptions would mirror the subjects that a board may consider in
5 closed executive session. Existing law recognizes the confidentiality of such
6 communications.

7 **Deadline for Response**

8 The Davis-Stirling Act sets out a series of time periods for response to a record
9 inspection request¹¹⁵ The proposed law would continue the existing time periods,
10 and would add a new rule for documents that have not yet been prepared at the
11 time that they are requested.¹¹⁶

12 **Redaction**

13 The Davis-Stirling Act provides some protection against identity theft, fraud,
14 and invasion of privacy by listing certain types of information that an association
15 may redact before allowing inspection of a record.¹¹⁷

16 It is not clear why redaction is optional. An association should never disclose
17 such things as a member’s social security number or checking account number to
18 another member.

19 The proposed law would make redaction mandatory.¹¹⁸

20 **Judicial Enforcement**

21 Existing law provides a number of different mechanisms for judicial
22 enforcement of member record inspection and record privacy rights.¹¹⁹ The
23 proposed law combines and simplifies the substance of those provisions, as
24 follows:

- 25 • Proposed Civil Code Section 4725 states substantive limitations on the use
26 of association records and authorizes the association to deny a request when

114. See proposed Civ. Code § 4700(a)(13).

115. See Civ. Code § 1365.2(j).

116. See proposed Civ. Code §4705(b).

117. Civ. Code § 1365.2.

118. See proposed Civ. Code § 4710.

119. See Civ. Code §§ 1365.2(e) (action for damages resulting from misuse of records), (f) (action to enforce inspection right and impose penalty); Corp. Code §§ 8331 (action to set aside record request), 8331(j) (writ of mandate to compel production of membership list), 8332 (petition to limit production of membership list on constitutional grounds), 8335 (action to postpone meeting on grounds of delay in complying with record request), 8336 (action to enforce valid inspection request), 8337 (award of costs and attorney’s fees to members where noncompliance unjustified), 8338 (action for damages resulting from misuse of membership list).

1 it reasonably believes that the records will be misused or that disclosure
2 would violate a member's constitutional rights.

- 3 • Proposed Civil Code Section 4730 provides a procedure for denial of a
4 record inspection request. It requires a formal notice of denial, which
5 includes an offer to use the association's internal dispute resolution process.
6 If the member objects to the denial decision, the association must either
7 comply with the request or commence a proceeding to set aside the request.
8 If the member does not object in the time provided, then the request expires
9 and the association need do nothing further.
- 10 • Proposed Civil Code Section 4735 authorizes a member to bring an action in
11 the superior court to enforce a record inspection request. The action would
12 turn on a small number of fairly straightforward factual questions: is the
13 requested record subject to inspection, did the requesting member follow
14 procedures, is an action pending to set the request aside, or was the request
15 in fact set aside by the court? The action may be filed in the small claims
16 division. The court may impose a civil penalty of up to \$500 against an
17 association that withholds records unreasonably.

18 If the court finds that the requested disclosure would violate member
19 constitutional rights or that there is a reasonable likelihood that disclosure
20 would result in misuse of the records, the court may modify or set aside the
21 request. The court may toll any association deadline, postpone an
22 association meeting, or order any other relief that may be appropriate under
23 the circumstances. The court may award costs and expenses against either
24 party, under specified conditions.

- 25 • Proposed Civil Code Section 4740 provides for an action to enjoin the
26 improper use of records and award damages for harms that result from
27 misuse. An association that prevails under the section would be awarded
28 costs and expenses.

29 The Comments and notes following these provisions highlight differences from
30 existing law.

31 Record Keeping

32 Duty to Maintain

33 The Corporations Code requires that the board of directors maintain accounting
34 records, meeting minutes, and the membership list.¹²⁰

35 That requirement would be continued in the proposed law.¹²¹ The list of records
36 that must be maintained would be expanded to include all of the types of records
37 that are subject to member inspection and other types of business records that
38 should be maintained by any well-run nonprofit organization.

39 In developing the latter category of records, the Commission looked to common
40 practice within the nonprofit sector. There is a wide range of advice available on

120. Corp. Code § 8320.

121. Civ. Code §4775.

1 the topic, including some that is specific to homeowner associations.¹²² The
2 proposed law is generally consistent with that body of advice.

3 **Record Retention Period**

4 A provision requiring the maintenance of specified records raises the question of
5 how long those records must be kept. That question is not answered in the
6 Corporations Code.

7 The Davis-Stirling Act provides a partial answer. It sets out periods during
8 which records must be made available to members for inspection:

9 The time periods for which specified records shall be provided is as follows:

10 (1) Association records shall be made available for the current fiscal year and
11 for each of the previous two fiscal years.

12 (2) Minutes of member and board meetings shall be permanently made
13 available. If a committee has decisionmaking authority, minutes of the meetings
14 of that committee shall be made available commencing January 1, 2007, and shall
15 thereafter be permanently made available.¹²³

16 An association director who reads that provision might assume that it states the
17 only applicable requirement for retention of the specified records. That would be a
18 mistake. Some of the listed documents are subject to specific retention
19 requirements that exceed three years.¹²⁴ In addition, documents that could be
20 relevant in future litigation should be maintained for at least as long as the
21 applicable statute of limitations.¹²⁵ As a practical matter, the governing documents
22 and records relating to their amendment should be kept permanently, as they are
23 fundamental to the governance of the association and the rights of members.

24 The proposed law would provide clear record retention rules. It identifies certain
25 types of records that must be retained permanently.¹²⁶ All other records that an
26 association is required to maintain would be retained for at least four years.¹²⁷ That
27 should satisfy retention requirements imposed by other law, most of which require
28 that a document be preserved for three to four years.

122. See, e.g., Walter Grady, *Record Retention*, Echo Journal, March 2003.

123. Civ. Code § 1365.2(i).

124. See, e.g., 22 Cal. Code Regs. § 1085-2 (employment records maintained for four years); 26 C.F.R. § 1.6001-1(e) (federal tax records maintained while material to tax assessment or collection).

125. See, e.g., Code Civ. Proc. §§ 318 (five year period for action relating to title to real property), 337(1) (four year period for action on written contract), 337.1 (four year period for action on patent construction defect), 337.15 (ten year period for action on latent construction defect), 338(a) (three year period for action on liability created by statute), 338(b) (three year period for trespass or injury to real property), 338(d) (three year period for action for fraud or mistake), 338(g) (three year period for slander of title), 343 (four year period for actions not otherwise provided for), 359 (three year period for action against director or member of corporation for penalty, forfeiture, or liability created by law).

126. See proposed Civ. Code § 4780(b).

127. See proposed Civ. Code § 4780(a).

1 Annual Reports

2 Existing law requires that an association distribute four different annual reports
3 to its membership:

- 4 (1) A pro forma operating budget must be delivered from 30 to 90 days before
5 the end of the fiscal year.¹²⁸ A number of other provisions require that
6 specified information be distributed with the budget.¹²⁹
- 7 (2) In an association with \$75,000 or more in annual gross income, a CPA
8 review of the association’s financial statement must be distributed, within
9 120 days after the end of the fiscal year.¹³⁰
- 10 (3) An annual financial report must be distributed within 120 days after the end
11 of the fiscal year.¹³¹
- 12 (4) A nonprofit “community service organization” that provides services to an
13 association and receives 10 percent or more of its funding from the
14 association or its members is required to provide an annual financial
15 statement to the association.¹³²

16 For the most part, the proposed law would simplify those requirements without
17 making substantive changes to existing law. Significant changes are described
18 below.

19 **Notice of Availability**

20 Existing law recognizes that there may be members who are not interested in
21 receiving every report. For example, a summary of the pro forma operating budget
22 may be distributed rather than the budget itself.¹³³ The summary must include
23 instructions on how to request a copy of the complete budget. A member who
24 requests the budget will be provided with a copy at no cost.

25 Similarly, the Corporations Code provides for distribution of notice of the
26 availability of a nonprofit mutual benefit corporation’s annual report, rather than
27 the report itself.¹³⁴ Again, instructions are to be provided on how to obtain a
28 complete copy of the report at no cost.

128. Civ. Code § 1365(a).

129. See, e.g., Civ. Code §§ 1363.850 (notice of informal dispute resolution process), 1365(d) (assessment collection policy), 1365(e) (summary of insurance coverage), 1365.1 (assessment collection policy), 1365.2.5 (assessment and reserve summary), 1369.490 (notice of alternative dispute resolution requirements), 1378 (architectural review procedure).

130. Civ. Code § 1365(b).

131. Corp. Code §§ 8321-8322

132. Civ. Code § 1365.3.

133. Civ. Code § 1365(c).

134. Corp. Code § 8321.

1 The proposed law would generalize that approach so that it applies to all of the
2 annual reports.¹³⁵ For each type of report, the association would only be required
3 to deliver notice of availability. However, any member who requests the full report
4 would receive it free of charge. An association would also be free to distribute the
5 complete report, rather than a notice of its availability, if that is the preferred
6 approach.

7 **Member Handbook**

8 Over time, the law has been amended to add several new disclosures to the
9 mailing of the annual budget report. The proposed law would combine the
10 nonbudgetary disclosures into a new type of report, the “member handbook.”¹³⁶
11 This would not diminish the information available to members, but would
12 repackage it into more thematically coherent groups. This should increase the
13 efficiency of the “notice of availability” approach described above, by offering
14 members clearer choices as to the types of information they wish to receive.

15 Government Assistance

16 The proposed law would continue two sections that relate to government
17 involvement in the governance of CIDs, without substantive change.¹³⁷

18 In addition, the proposed law would add a new provision, authorizing the
19 Attorney General to act on certain complaints regarding CID governance.¹³⁸ That
20 provision would be consistent with the spirit of existing law, as discussed below.

21 The Corporations Code currently authorizes the Attorney General to act on a
22 complaint that a nonprofit mutual benefit corporation is not complying with the
23 Corporations Code provisions governing member meetings, voting, and record
24 inspection.¹³⁹

25 However, there is a trend (which the proposed law would continue) to move the
26 substance of Corporations Code provisions into the Davis-Stirling Act. As a result,
27 the authority of the Attorney General to oversee *violations of the Corporations*
28 *Code* has diminished relevance to CIDs.

29 The proposed law would restore that authority to its original dimension, by
30 adding a provision that expressly authorizes the Attorney General to act on
31 complaints regarding a violation of the Davis-Stirling Act provisions on member

135. See proposed Civ. Code § 4820.

136. See proposed Civ. Code § 4810.

137. See Civ. Code §§ 1363.001 (online director training course), 1363.6 (Secretary of State registry of CIDs). Those sections would be continued as proposed Civil Code Sections 4950 and 4960, respectively.

138. See proposed Civ. Code § 4955.

139. Corp. Code § 8216.

1 meetings, voting, and record inspection.¹⁴⁰ As under existing law, the Attorney
2 General's authority would be largely discretionary.

3 DISPUTE RESOLUTION

4 Existing law includes a number of provisions that relate to the resolution of a
5 dispute within a CID. For the most part, those provisions would be continued
6 without substantive change. Significant changes are discussed below.

7 **Internal Dispute Resolution and Member Discipline**

8 Existing law requires that an association provide an internal dispute resolution
9 procedure for use by a homeowner who has a dispute with the association.¹⁴¹ The
10 point of the internal dispute resolution process is to make sure that a homeowner
11 has an opportunity to meet with a representative of the board and explain his or
12 her side of a dispute, in the hopes that the problem can be resolved by mutual
13 agreement.

14 The procedure for imposition of member discipline serves the same purpose, by
15 providing an opportunity to be heard by the board.¹⁴²

16 The proposed law would make clear that a matter resolved through the member
17 discipline procedure could not be reopened under the internal dispute resolution
18 procedure.¹⁴³ That would be unnecessarily duplicative.

19 **Civil Action to Enforce Statutory CID Law**

20 There are a number of existing provisions that provide for a civil action to
21 enforce a specific provision of the Davis-Stirling Act.¹⁴⁴

22 Those provisions cover much, but not all of CID statutory law. That incomplete
23 coverage may create an implication that judicial enforcement is unavailable except
24 where it is specifically authorized. For example, the Davis-Stirling Act provides
25 that an association is responsible for maintenance of the common area,¹⁴⁵ but there
26 is no specific provision authorizing a civil action to enforce that obligation. It is
27 therefore not clear whether such an action may be brought.

28 The Commission sees no policy reason to authorize judicial enforcement of the
29 specific provisions listed above, while denying judicial enforcement of other
30 important provisions of the Davis-Stirling Act (e.g., an owner's right of access to a

140. See proposed Civ. Code § 4955.

141. See Civ. Code §§ 1363.810-1363.850.

142. See proposed Civ. Code §§ 5000-5015.

143. See proposed Civ. Code § 5050(c).

144. See, e.g., §§ 1353.5 (display of U.S. flag), 1363.09 (election and board meeting), 1365.2(f) (record inspection), 1368(d) (seller disclosure); Corp. Code §§ 7510(c)-(d) (member meeting), 7515, 8323 (annual report), 8336 (record inspection).

145. Civ. Code § 1364(a).

1 separate interest, rulemaking procedure, architectural review procedure, etc.). The
2 proposed law would authorize a civil action to enforce any provision of the Davis-
3 Stirling Act.¹⁴⁶

4 RESERVE FUNDS

5 **Background**

6 The distinguishing feature of a common interest development is that the owners
7 of separate interests also have an interest in common property (either directly or
8 through an entity created for that purpose). The homeowner association exists, in
9 large part, to maintain that common property.

10 Ideally, an association will set aside funds in reserve, to provide for future
11 maintenance, repair, and replacement costs as they come due. If an association
12 fails to do so, the members may need to pay a special assessment in order to pay
13 for a needed repair or the replacement of a failed component. A large unexpected
14 assessment can pose a serious financial hardship for an owner, especially one who
15 is retired and cannot easily make up the loss.

16 An unfunded reserve can also lead to unexpected liability for a new purchaser. A
17 prospective purchaser who does not realize that the association has insufficient
18 reserves to cover looming repair costs cannot take those costs into account in
19 negotiating a purchase price.

20 Underfunding of reserves appears to be common. One survey of 687
21 associations found an average funding rate of 54%. That is, the surveyed
22 associations only had 54% of the funds in reserve that would be needed for future
23 repair and replacement costs.¹⁴⁷

24 **Reserve Study**

25 Existing law does not require that an association fully fund its reserves. Instead,
26 the law requires study and disclosure. An association must prepare an annual
27 reserve study, which identifies all of its future repair responsibilities and compares
28 the cost of those repairs to the amount set aside in the reserve fund. This serves
29 two important purposes:

- 30 (1) It educates the board and the membership about the adequacy of the
31 association's reserve fund.
- 32 (2) It provides information that a prospective buyer can use to assess the hidden
33 cost of purchasing a unit in a CID with underfunded reserves.

146. See proposed Civ. Code § 5130.

147. See T. Berding, *The Uncertain Future of Community Associations, Thoughts on Financial Reform* 25 (January 2005).

1 The current rules on reserve funding are spread across multiple provisions.¹⁴⁸ It
2 is difficult to read those sections together and get a clear picture of what is
3 required.

4 The proposed law would restate the substance of the existing requirements in
5 significantly simplified form.¹⁴⁹

6 **Reserve Funding Plan**

7 An association must also adopt a “reserve funding plan.” The plan would
8 “include a schedule of the date and amount of any change in regular or special
9 assessments that would be needed to sufficiently fund the reserve....”¹⁵⁰

10 The proposed law would restate the substance of the existing requirements in
11 significantly simplified form.¹⁵¹

12 **ASSESSMENTS**

13 An association is required to impose assessments sufficient to perform its
14 obligations. However, an assessment may not exceed the amount required to
15 accomplish the purpose for which it is assessed.¹⁵²

16 **Assessment Increase**

17 Under existing law, an association may increase its assessments by any amount
18 that is required to meet its obligations, even if the governing documents purport to
19 limit assessment increases.¹⁵³ However, an increase above a certain amount must
20 be approved by the members.¹⁵⁴ The provision establishing those rules is poorly
21 phrased, but legislative history makes its meaning clear.¹⁵⁵

22 The proposed law restates those rules to improve their clarity, without changing
23 their substance.¹⁵⁶

148. See Civ. Code §§ 1365(a)(2), 1365.2.5, 1365.5.

149. See proposed Civ. Code § 5555.

150. See Civ. Code §§ 1365(a)(3)-(4), 1365.5(e)(5).

151. See proposed Civ. Code § 5560.

152. See Civ. Code §§ 1366(a), 1366.1; proposed Civ. Code § 5575.

153. Civ. Code § 1366(b).

154. *Id.*

155. See Senate Housing and Urban Affairs Committee Analysis of AB 279 (July 1, 1987) (on file with Commission); Letter from Senate Housing and Urban Affairs Committee to Senator Leroy F. Greene (August 20, 1987) (on file with Commission). See also C. Sproul and K. Rosenberry, *Advising California Common Interest Communities* § 5.4, at 283-84 (Cal. Cont. Ed. Bar 2006).

156. See proposed Civ. Code § 5580.

1 **Assessment Collection**

2 Assessment collection is governed by several complex and partially overlapping
3 sections.¹⁵⁷

4 The proposed law regroups the material by subject matter, and presents it as a
5 series of relatively short sections that roughly track the order of the procedural
6 steps involved in collecting an overdue assessment.¹⁵⁸

7 **Application Dates**

8 The existing assessment collection provisions have differing application dates:

- 9 • Civil Code Section 1367 applies to a lien created on or after January 1,
10 1986, and before January 1, 2003.
- 11 • With one exception, Civil Code Section 1367.1 applies to a lien created on
12 or after January 1, 2003. A requirement that the board make the decision to
13 record a lien applies on or after January 1, 2006.
- 14 • Civil Code Section 1367.4 applies to a lien created on or after January 1,
15 2006. However, Section 1367.1 is expressly “subordinate to” Section
16 1367.4. Arguably, that means that Section 1367.4 also applies to any lien
17 created on or after January 1, 2003.

18 The proposed law restates those rules in simpler terms.¹⁵⁹

19 **GOVERNING DOCUMENTS**

20 **Hierarchy of Document Authority**

21 The proposed law establishes a formal hierarchy of authority between the
22 different types of governing documents.¹⁶⁰ The articles would be bound by the
23 declaration. The bylaws would be bound by both the articles and the declaration.
24 An operating rule would be subordinate to all of the other document types. The
25 express statement of those rules should help to avoid any uncertainty about the
26 relationship between different types of documents.

27 **Restrictive Covenants**

28 Existing law requires that illegal discriminatory covenants be deleted from the
29 governing documents, and provides an expedited procedure for doing so.¹⁶¹ That
30 section would be restated in the proposed law, with a new requirement that an
31 amended declaration be recorded and that amended articles of incorporation be

157. See Civ. Code §§ 1365.1, 1366.2, 1366.2.7, 1367, 1367.1, 1367.4, 1367.5.

158. See proposed Civ. Code §§ 5600-5675.

159. See proposed Civ. Code §§ 5650(c) (special rule for limitations on foreclosure), 5675 (general rule).

160. See proposed Civ. Code § 6005

161. Civ. Code § 1352.5.

1 filed with the Secretary of State.¹⁶² Those new requirements are consistent with the
2 general practice for amending those documents.¹⁶³

3 CONSTRUCTION DEFECT LITIGATION

4 Existing law includes fairly lengthy provisions setting out procedural
5 prerequisites to an association filing a construction defect lawsuit against a
6 developer or builder.¹⁶⁴ The proposed law would leave those provisions unchanged
7 to the maximum extent possible. The section numbers would change and cross-
8 references would be updated, but no other changes would be made.¹⁶⁵

9 DEFERRED OPERATION

10 The proposed law should be given a one year deferred operative date. That
11 would give practitioners time to adjust to the new organization of the law. It would
12 also provide an opportunity for a follow-up bill to coordinate the proposed law
13 with any changes to the law that are made in the same year that the proposed law
14 is enacted.

15 REQUEST FOR COMMENT

16 The Commission invites public comment on the changes that are described
17 above. The Commission also invites comment on any other aspect of the proposed
18 reorganization of the Davis-Stirling Act, including in particular the issues raised in
19 notes within the proposed legislation, below.

162. See proposed Civ. Code § 6150.

163. See Civ. Code §§ 1355 (declaration); Corp. Code § 7814, 7817 (articles).

164. Civ. Code §§ 1375-1375.1.

165. See proposed Civ. Code §§ 6200-6215.