Study H-855 September 14, 2010

Memorandum 2010-47

Common Interest Development: Statutory Clarification and Simplification of CID Law (Comments on Definition Provisions)

This memorandum continues the analysis and discussion of the public comments received on the Commission's tentative recommendation on *Statutory Clarification and Simplification of CID Law* (Feb. 2010). It addresses comments on the definition provisions of the proposed law.

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

Because of the large number of comments and the importance of completing review of those comments before the end of this year, if possible, this memorandum employs a practice that the Commission sometimes uses to expedite review of voluminous material — issues that appear to require Commission discussion at the meeting are marked with the "☞" symbol in the heading for that issue.

All other issues in the memorandum are presumed to be noncontroversial "consent" items, that are deemed approved without discussion. *That is only a presumption, and Commissioners and members of the public will have an opportunity to discuss those issues at the meeting, if discussion is needed.*

Where this memorandum sets out a provision of the proposed law, the text includes any changes that were approved at the August 2010 meeting.

Except as otherwise indicated, all statutory references in this memorandum are to the Civil Code.

"ASSOCIATION" DEFINED

Proposed Section 4080 would continue the existing definition of "association" without change, thus:

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting.

> 4080. "Association" means a nonprofit corporation or unincorporated association created for the purpose of managing a common interest development.

The California State Bar Real Property Section Working Group ("RPLS Working Group") suggests that the definition be revised to expressly address whether an association can be formed as a for-profit corporation. See Memorandum 2010-36, Exhibit p. 113.

The staff recommends against doing so in the current study. The issue is important, but it involves a substantive issue that should be addressed as part of a separate study of CID formation issues.

"BOARD MEETING" DEFINED

Proposed Section 4090 would continue the existing definition of "board meeting," with one significant change (which is explained below). The section would provide as follows:

> 4090. "Board meeting" includes any congregation at the same time and place, of a sufficient number of directors to establish a quorum of the board, to hear, discuss, or deliberate upon any item of business scheduled to be heard by the board, except those matters that may be discussed in executive session.

Comments on the proposed definition are discussed below.

"Includes" v. "Means"

Kazuko K. Artus points out that proposed Section 4090 is the only definition in the proposed law that uses the word "includes" (i.e., "'board' meeting includes …"). Most of the definitions use the word "means" rather than "includes" (e.g., "'Association' means …"). She suggests that Section 4900 be revised to use "means." See Memorandum 2010-36, Exhibit p. 51.

Although this would be a change from the language of existing law, the staff agrees that it would be an improvement. The term "includes" generally implies that a definition is not exhaustive and that the defined term may have other meanings.

That implication is problematic in this instance. The term "board meeting" is crucial in determining the scope of application of important procedural rules governing meetings. The meaning of the term should be certain.

To avoid any misunderstanding, the staff recommends that "includes" be replaced with "means" (i.e., "'board' meeting *means* …").

Unscheduled Matters

The existing definition, continued in proposed Section 4090, would limit a "board meeting" to a specified gathering "to hear, discuss, or deliberate upon any item of business *scheduled to be heard* by the board…." (Emphasis added.)

Read literally, this means that a group of directors can gather to discuss board business without violating the open meeting requirements (because their gathering is not a "board meeting"), so long as the matters discussed have not been "scheduled to be heard" by the board. Only if the topic of discussion is scheduled to be heard (presumably at the next scheduled board meeting) would the gathering be a "board meeting" that is subject to regulation under the Davis-Stirling Act's open meeting provisions.

Ms. Artus objects to that result. She believes that any gathering of a sufficient number of directors should be treated as a "board meeting" if they are working on *any* board business, regardless of whether the business is "scheduled to be heard." See Memorandum 2010-36, Exhibit p. 52.

That concern is reasonable. The point of the open meeting requirement is to provide members with advance notice and an opportunity to be heard whenever the board meets to consider and make decisions on board business. It isn't clear why that policy should only extend to matters that have been formally scheduled to be heard at the next meeting.

In fact, as Ms. Artus points out, an earlier draft of the proposed law would have eliminated the "scheduled to be heard" language. However, that proposed change proved to be controversial and there was strongly divided opinion on its merits. The Commission concluded that, regardless of its merits, the change was too controversial for inclusion in the proposed law. It was removed for that reason. See First Supplement to Memorandum 2007-17, pp. 29-30.

The staff does not see any reason to reverse that prior decision. Instead, the issue should be noted for possible future study.

Exclusion of Executive Session Matters

Ms. Artus objects to the last clause of the definition, which provides an exception for "those matters that may be discussed in executive session" (hereafter the "executive session exception"). See Memorandum 2010-36, Exhibit p. 52. Duncan R. McPherson, writing on behalf of a group of attorneys who are

expert in CID formation issues (the "McPherson Group"), also questions the need for the executive session exception. See Memorandum 2010-36, Exhibit p. 13.

Under the executive session exception, a gathering of board members to discuss matters that can be considered in executive session *is not a "board meeting."* Consequently, none of the provisions that regulate board meetings apply to a gathering that is subject to the executive session exception.

For example, existing law requires advance notice of a board meeting, limits action at a board meeting to the matters listed on the agenda that must be included with the notice, and requires the preparation of minutes of the meeting. See proposed Sections 4920, 4925, 4950. None of those requirements would apply to an informal gathering of board members discussing matters that could be heard in executive session.

This raises a policy question: should board members be permitted to hold a de facto executive session meeting, without any notice to the members or memorialization of the matters that were discussed?

The first version of the Commission's recommendation in this study did not continue the executive session exception. That change from existing law was opposed by the California Association of Community Managers ("CACM"), and the bill implementing the recommendation was amended to restore the executive session exception language. See First Supplement to Memorandum 2008-12, p. 4.

Given that prior opposition and the Commission's prior decision that a substantive change on this issue would be too controversial for inclusion in the proposed law, **the staff recommends against making any change to existing law on this point.** That said, there are a number of issues relating to the open meeting requirements of the Davis-Stirling Act that would benefit from separate study.

☞ Quorum v. Majority

The existing definition requires that a *majority* of the board congregate in order for there to be a meeting. See Section 1363.05(j). Proposed Section 4090 would instead require that *a number of board members comprising a quorum* meet.

This change is premised on the notion that a "meeting" occurs when there is a gathering of a sufficient number of board members to take action on behalf of the board. That would not necessarily be a simple majority, as a board may have a quorum that is lower or higher than a majority.

As noted in the introduction above, the proposed law would change the threshold number of board directors required for a "board meeting" from a majority of the board to a quorum.

Ms. Artus supports that change. See Memorandum 2010-36, Exhibit p. 52.

The RPLS Working Group opposes the change. That opposition seems to be grounded in a policy argument that boards should not be *allowed* to have a quorum of less than a majority. See Memorandum 2010-36, Exhibit pp. 113-14.

Regardless of the merits of that policy position, it does not seem relevant to the issue at hand. Proposed Section 4090 has no effect on the size of a board's quorum. It simply provides that a gathering of directors comprising a quorum, discussing the specified type of business, is a board meeting for the purposes of the provisions regulating board meetings. If the board's quorum is 33%, then a congregation of 33% or more should be a meeting. If the quorum is 66%, then a meeting would exist only when 66% or more of the board congregate. It may be true that most boards require a simple majority to establish a quorum. In those cases, a congregation of a simple majority would be a meeting. The proposed law simply acknowledges existing variation.

Regardless of whether a board *should* be permitted to have a quorum less than a simple majority, *the law currently permits that result*. See Corp. Code § 7211.

In the staff's view, an objection to the quorum rule provided in Corporations Code Section 7211 is not a good reason to oppose proposed Section 4090, which would have no effect on that substantive issue. Section 4090 simply provides that any gathering of a quorum — *whatever that number may be* — is a meeting.

The staff recommends against changing the quorum language in proposed Section 4090. The question of whether the law should prohibit CID boards from having a quorum of less than a majority should be addressed directly, when quorum issues are discussed in a future memorandum discussing board meeting provisions.

"COMMON AREA" DEFINED

Proposed Section 4095 would continue the existing definition of "common area," as follows:

> 4095. (a) "Common area" means the entire common interest development except the separate interests therein. The estate in the common area may be a fee, a life estate, an estate for years, or any combination of the foregoing.

(b) Notwithstanding subdivision (a), in a planned development described in subdivision (b) of Section 4175, the common area may consist of mutual or reciprocal easement rights appurtenant to the separate interests.

Subdivision (a) states the general definition. Subdivision (b) provides a special definition for use in an unusual type of development described in proposed Section 4175(b). Comments on the definition are discussed below.

Life Estate

The RPLS Working Group suggests deleting the reference to a "life estate" in proposed Section 4095(a). The group feels that the term is unnecessary. See Memorandum 2010-36, Exhibit p. 115.

It does seem peculiar for title to the common area to be held as a life estate. It is hard to imagine a situation where that sort of ownership would arise.

However, before reading the letter from the RPLS Working Group, the staff would also have found the idea of common area being held for a "term of years" equally peculiar. But the RPLS Working Group indicates that such CIDs do exist.

Note too that this is not the only provision that refers to life estate ownership of common area. Existing Section 1351(e)(3) (proposed Section 4290) provides special procedural rules for condominiums that are subject to a life estate or term of years.

Unless the Commission is *certain* that the life estate language serves no purpose, it should not be deleted. **The staff does not have that certainty and recommends against deleting the language.**

"Entire" Development

The McPherson Group suggests that use of the word "entire" in proposed Section 4095(a) could cause problems in "phased projects."

The staff believes that suggestion turns on a technical formation issue that should be included in a separate study of formation matters.

Reciprocal Easements as Common Area

Subdivision (b) of proposed Section 4095 provides a special definition of "common area" for use in an unusual type of planned unit development — one where the common area is not owned by the association or the members in common, but instead consists of reciprocal easements. Such a development is

only a CID if it has an association with the authority to levy assessments that can be enforced through liens, as described in proposed Section 4175(b).

For example, a development might be structured so that the roads are divided into separate portions, with each portion owned by a single lot owner, and all owners having reciprocal easement rights to travel over each others' portions. Such a development would only be a CID if it has the liening authority described in Section 4175(b).

The McPherson Group suggests it might be better to combine the language from 4095(b) and 4175(b), to describe this special type of CID, rather than having the description divided between two sections. The group also suggests rephrasing the language used in subdivision (b) of proposed Section 4095. See Memorandum 2010-36, Exhibit p. 15.

The RPLS Working Group also suggests rephrasing proposed Section 4095, but with very different language. See Memorandum 2010-36, Exhibit p. 115.

Proposed Section 4095 would simply continue the existing definition of "common area." **The staff recommends against tinkering with the language of the section at this time.** Any adjustments to the language should be considered in connection with a broader study of formation related issues.

Reciprocal Easements and Maintenance Obligations

CACM points out that defining "common area" as including property subject to reciprocal easements has implications with respect to an association's maintenance obligations. For example, proposed Section 4775(a), which continues existing law, provides that the association is generally responsible for the maintenance of common area. In the hypothetical development described above, that would obligate the association to maintain the roads. See Memorandum 2010-36, Exhibit p. 207.

The staff does not see the problem. If the roads are common area, why shouldn't the association be required to maintain them (as opposed to having each individual member separately repave the portion of the road that member owns)? That would seem to follow from the letter of existing law. **If CACM would like that law to be substantively changed, it should suggest how and why.**

"COMMON INTEREST DEVELOPMENT" DEFINED

Proposed Section 4100 would continue the existing definition of "common interest development" without change:

> 4100. "Common interest development" means any of the following:
> (a) A community apartment project.
> (b) A condominium project.
> (c) A planned development.
> (d) A stock cooperative.

The McPherson Group writes that it is common for a CID to consist of some combination of the four listed development types, and that the definition should be revised to reflect that fact. See Memorandum 2010-36, Exhibit p. 15.

The suggested revision involves technical formation issues that have not yet been adequately researched (e.g., the legal relationship between affiliated CIDs and master associations). **The issue should be included in a separate study of formation matters.**

"COMMUNITY SERVICE ORGANIZATION" DEFINED

Proposed Section 4110 would continue the existing definition of "community service organization" without change, except that the term "resident" would be replaced with "occupant." This was done in order to standardize references to occupants and residents, using a single defined term.

Comments on that proposed standardization are discussed below, under "'Occupant' Defined."

In addition, the Real Property Law Section Working Group has concerns about the scope of the existing definition of "community service organization," especially as it relates to an existing prohibition on a community service organization receiving transfer fees when a separate interest changes hands. See proposed Section 4575 (which would continue existing Section 1368(c)(1) without change). The RPLS Working Group is not suggesting that its concerns about this provision be addressed in the current project. It acknowledges that such issues are likely to be controversial. See Memorandum 2010-36, Exhibit pp. 115-17. **The issue should be noted for possible future study by the Commission.**

"CONDOMINIUM PLAN" DEFINED

Proposed Section 4120 would continue the existing definition of "condominium plan" without substantive change, as follows:

> 4120. "Condominium plan" means a plan consisting of:
> (a) A description or survey map of a condominium project, which shall refer to or show monumentation on the ground.
> (b) A three-dimensional description of a condominium project, one or more dimensions of which may extend for an indefinite distance upwards or downwards, in sufficient detail to identify the common area and each separate interest.
> (c) A certificate consenting to the recordation of the condominium plan pursuant to this Act that is signed and acknowledged as provided in Section 4290.

The Commission received two comments on this provision.

One or More Condominium Projects Described

The McPherson Group suggests that the definition be revised slightly to acknowledge that a condominium plan may describe *one or more* condominium projects. See Memorandum 2010-36, Exhibit p. 16.

The staff is concerned that the proposed revision might have unintended consequences. For example, proposed Sections 4290 and 4295 provide rules for the recordation and amendment of a "condominium plan." Those provisions require a certificate signed by all fee owners of property within the condominium project. Under existing law, if a single document sets out condominium plan information for more than one project (Project A and Project B), one could at least argue that the document sets out two different condominium plans (Plan A and Plan B), rather than a single condominium plan covering both projects. Why would this matter? If the owners in Project A want to amend their condominium plan, do they need to collect the signatures from all owners in Project B? If there is only one condominium plan, then perhaps yes. If the single document contains two different plans, then perhaps no.

Given the uncertainty about this issue (and perhaps others), the staff recommends against changing the language as recommended.

Relocate the Provision

The RPLS Working Group approves of the changes made to the text of the definition. However, they suggest that it be moved adjacent to other substantive

provisions addressing condominium plans. See Memorandum 2010-36, Exhibit p. 117-18.

If that change were made, proposed Section 4120 would be revised to contain only a cross-reference to the relocated provision describing the contents of a condominium plan. Thus:

> **§ 4120. "Condominium plan"**
>
> 4120. "Condominium plan" means a plan ~~consisting of:~~ having the contents described in Section 4290.

> **§ 4290. Content of condominium plan**
>
> 4290. A condominium plan shall contain all of the following information:
>
> (a) A description or survey map of a condominium project, which shall refer to or show monumentation on the ground.
>
> (b) A three-dimensional description of a condominium project, one or more dimensions of which may extend for an indefinite distance upwards or downwards, in sufficient detail to identify the common area and each separate interest.
>
> (c) A certificate consenting to the recordation of the condominium plan pursuant to this Act that is signed and acknowledged as provided in Section 4290.

(The current provisions of the proposed law at Sections 4290 and 4295 would need to be renumbered if this change were made.)

This strikes the staff as a good suggestion. The material that is currently included in proposed Section 4120, defining the necessary contents of a condominium plan, is fairly substantive. It would probably be more user-friendly if that substance were located in the proposed article on "Condominium Plans," alongside the rules for recordation, amendment, and revocation of condominium plans. **The staff recommends that this change be made.**

"CONDOMINIUM PROJECT" DEFINED

Proposed Section 4125 would continue the existing definition of "condominium project" without substantive change:

> 4125. (a) A "condominium project" means a development consisting of condominiums.
>
> (b) A condominium consists of an undivided interest in common in a portion of real property coupled with a separate interest in space called a unit, the boundaries of which are described on a recorded final map, parcel map, or condominium plan in sufficient detail to locate all boundaries thereof. The area

within these boundaries may be filled with air, earth, or water, or any combination thereof, and need not be physically attached to land except by easements for access and, if necessary, support. The description of the unit may refer to (1) boundaries described in the recorded final map, parcel map, or condominium plan, (2) physical boundaries, either in existence, or to be constructed, such as walls, floors, and ceilings of a structure or any portion thereof, (3) an entire structure containing one or more units, or (4) any combination thereof.

(c) The portion or portions of the real property held in undivided interest may be all of the real property, except for the separate interests, or may include a particular three-dimensional portion thereof, the boundaries of which are described on a recorded final map, parcel map, or condominium plan. The area within these boundaries may be filled with air, earth, or water, or any combination thereof, and need not be physically attached to land except by easements for access and, if necessary, support.

(d) An individual condominium within a condominium project may include, in addition, a separate interest in other portions of the real property.

The McPherson Group suggests two minor technical changes to the language used in that section.

First, they would add the words "real property" before the word "development," thus: "real property development." That could be a helpful clarification, which does not seem to create any risk of unintended change in meaning. A similar revision in another provision was approved at the August 2010 meeting. **The staff recommends that the change be made.**

Second, the group suggests that the list of things that can fill the boundaries of a condominium unit be revised to include a reference to "fixtures," thus:

> The area within those boundaries may be filled with air, earth, ~~or~~ water, or fixtures, or any combination thereof…

The proposed change seems to be a harmless and potentially helpful clarification. In many cases a condominium building's structural elements (e.g., walls, floors, ceilings) will be common area, while the interior of the separate interest "unit" contains fixtures such as interior lighting or cabinets. In this common scenario, the area within the boundaries of the unit may contain fixtures. **The staff recommends that the proposed revision be made.**

"DECLARANT" DEFINED

Proposed Section 4130 would continue the existing definition of "declarant" without change:

> 4130. "Declarant" means the person or group of persons designated in the declaration as declarant, or if no declarant is designated, the person or group of persons who sign the original declaration or who succeed to special rights, preferences, or privileges designated in the declaration as belonging to the signator of the original declaration.

The Real Property Law Section Working Group makes two comments about the definition and use of the term "declarant." See Memorandum 2010-36, Exhibit pp. 118-19.

Successor Declarant

The RPLS Working Group suggests that the language describing a successor declarant should only apply to successors who are *expressly named* as successors in the association's governing documents. In this way, the original declarant could exercise control over which "successors" are subject to regulation by the Davis-Stirling Act provisions governing declarants.

That would be a significant substantive change in the law, which has not been examined by the Commission or subject to public review and comment. **The staff recommends that the issue be noted for possible future study.**

Developer v. Declarant

In two provisions of the proposed law, the term "developer" is replaced with the defined term "declarant." See proposed Sections 4230 (deletion of "developer provisions" from declaration), 5720 (exception to foreclosure limitations for assessments owed by "developer").

The Real Property Law Section Working Group opposes that proposed change in terminology. They assert that each substitution "Can and will create significant legal consequences…."

That concern is difficult to evaluate in the abstract, especially since the term "developer" is not defined in the Davis-Stirling Act (or in the Civil Code or Business and Professions Code). However, it is possible that the proposed substitutions *could* have unintended effects.

Out of caution, the staff recommends that the substitutions be reversed.

"DECLARATION" DEFINED

Proposed Section 4135 continues the existing definition of "declaration" without substantive change:

> 4135. "Declaration" means the document, however denominated, that contains the information required by Sections 4250 and 4255.

As indicated, that definition is dependent on Sections 4250 and 4255, which specify the required content of a declaration.

This existing definition contains a significant flaw, that would not be caused or remedied by the proposed law.

The problem results from the fact that "declaration" is defined as a document that contains the information required by proposed Sections 4250 and 4255 (which would continue existing Section 1353). However, the requirements of those provisions *do not apply to all CIDs*. For example, proposed Section 4250 (which would continue existing Section 1353(a)(1) and (b) without substantive change), reads as follows:

> 4250. (a) A declaration, recorded on or after January 1, 1986, shall contain a legal description of the common interest development, and a statement that the common interest development is a community apartment project, condominium project, planned development, stock cooperative, or combination thereof. The declaration shall additionally set forth the name of the association and the restrictions on the use or enjoyment of any portion of the common interest development that are intended to be enforceable equitable servitudes.
>
> (b) The declaration may contain any other matters the declarant or the members consider appropriate.

As can be seen, the first sentence of subdivision (a) only applies to a declaration recorded on or after January 1, 1986. Although it is less clear, it appears that the second sentence of subdivision (a) is also inapplicable to a declaration recorded before 1986. Under that reading, proposed Section 4250(a) would not state any content requirements for a pre-1986 declaration.

By contrast, subdivision (b) seems to apply to all declarations, whenever recorded. But it is so broad as to be meaningless as a basis for defining "declaration." It could describe *any* document recorded by an association with the assent of its members.

Proposed Section 4255 does not help in defining "declaration" for pre-1986 CIDS, because its two requirements only apply to a document recorded on or after January 1, 2004, and January 1, 2006, respectively.

Consequently, in a pre-1986 CID, the meaning of "declaration" is uncertain. This is a significant problem, as recordation of a declaration is a prerequisite to the application of the Davis-Stirling Act. See proposed Section 4030 (which would be renumbered as Section 4200).

The McPherson Group suggests solving this problem by reframing the definition of "declaration." Rather than defining the term by reference to the content requirements of proposed Sections 4250 and 4255, the group proposes a definition that describes the substantive character of a declaration:

> "Declaration" means a recorded document which establishes equitable servitudes that governs the operation of a common interest development.

See Memorandum 2010-36, Exhibit p. 17.

The RPLS Working Group proposes coming at the problem from a different angle. It suggests revising proposed Section 4250 to add a default content requirement for CIDs with documents recorded before 1986. See Memorandum 2010-36, Exhibit p. 133.

Both suggestions make sense. However, the staff is concerned about trying to resolve such an important problem without more thorough research and public input than is possible in the context of the current study. Great care will need to be taken in addressing this problem, so as not to inadvertently draft a definition that is too narrow. **The staff recommends that this issue be studied as part of a separate study of CID formation issues.**

"DIRECTOR" DEFINED

Proposed Section 4140 would be a new provision. It would add a definition of the term "director":

> 4140. "Director" means a natural person elected, designated, or selected to serve on the board.

The McPherson Group suggests revising that definition as follows:

> 4140. "Director" means a natural person ~~elected, designated, or selected to serve~~ who serves on the board.

The group explains its suggestion as follows: "A person could be elected to the board before the actual term starts." See Memorandum 2010-36, Exhibit p.17. For example, a person elected in June to serve on the board in August should not be considered a "director" until that person's term actually commences. Under a literal reading of proposed Section 4140, the person would be a "director" immediately upon election. That drafting problem seems real and the proposed language would seem to cure it in a straightforward way. **The staff recommends that the proposed revision be made.**

"EXCLUSIVE USE COMMON AREA" DEFINED

Proposed Section 4145 would continue the existing definition of the term "exclusive use common area," ("EUCA") with one minor substantive change relating to telephone wiring (in subdivision (c)):

> 4145. (a) "Exclusive use common area" means a portion of the common area designated by the declaration for the exclusive use of one or more, but fewer than all, of the owners of the separate interests and which is or will be appurtenant to the separate interest or interests.
>
> (b) Unless the declaration otherwise provides, any shutters, awnings, window boxes, doorsteps, stoops, porches, balconies, patios, exterior doors, doorframes, and hardware incident thereto, screens and windows or other fixtures designed to serve a single separate interest, but located outside the boundaries of the separate interest, are exclusive use common area allocated exclusively to that separate interest.
>
> (c) Notwithstanding the provisions of the declaration, internal and external communication wiring designed to serve a single separate interest, but located outside the boundaries of the separate interest, are exclusive use common area allocated exclusively to that separate interest. For the purposes of this section, "wiring" includes nonmetallic transmission lines.

The Real Property Law Section Working Group makes a number of comments on this definition. See Memorandum 2010-36, Exhibit pp. 119-21. They are discussed below.

Designation in Other Governing Documents

The existing definition provides that EUCA rights must be designated in the *declaration*. The Real Property Law Section Working Group suggests broadening that rule to permit designation in other types of governing documents (condominium plans, subdivision maps, or deeds). See Memorandum 2010-36,

Exhibit pp. 119-20. **The staff recommends that this revision not be made at this time.** It requires more study and public input than is possible in the current project. The proposal should be considered as part of a study of CID formation issues (all of the specified types of governing documents are founding documents).

Maintenance Obligations Should be Clarified

The Real Property Law Section Working Group suggests that the proposed law be revised to clarify who is responsible for maintaining structures within EUCA. See Memorandum 2010-36, Exhibit p. 120. **That issue will be discussed in a later memorandum, in connection with provisions governing property use and maintenance.**

Telephone Wiring

Existing law provides that telephone wiring is deemed to be EUCA. See Section 1351(j).

Proposed Section 4145 would broaden that provision to include all communication wiring and to make clear that "wiring" includes nonmetallic transmission lines. This would update the rule to preserve its purpose notwithstanding changes in communication technology. For example, many people receive telephone service from a cable provider, or an Internet provider. Fiber-optic cables are nonmetallic.

The Real Property Law Section Working Group cautions that this change (and perhaps even existing law) is "largely preempted" by federal statutes and regulations.

The staff's preliminary look into this issue suggests that its resolution would require more research than could be completed in the current study. For that reason, **the staff recommends restoring the language of existing law in both this provision and in proposed Section 4790 (which includes a similar change). The question of how to resolve any problems caused by federal preemption should be noted for possible future study.**

Provision Governing Grant of EUCA

The Real Property Law Section Working Group also urges the Commission to carefully consider the substantive merits of existing Section 1363.07. (The group erroneously identifies proposed Section 4790 as the provision that would

continue Section 1363.07. The correct provision is proposed Section 4600.) See Memorandum 2010-36, Exhibit pp. 120-21.

The group's concerns about Section 4600 will be discussed in a later memorandum, in connection with property transfer issues.

"GOVERNING DOCUMENTS" DEFINED

Proposed Section 4150 would continue the existing definition of "governing documents" without change:

> 4150. "Governing documents" means the declaration and any other documents, such as bylaws, operating rules of the association, articles of incorporation, or articles of association, which govern the operation of the common interest development or association.

The Commission received two comments on that provision, which are discussed below.

Override by Declaration

The McPherson Group suggests adding language to permit the declaration to override the statutory definition of the term. See Memorandum 2010-36, Exhibit p. 18.

The staff recommends against making that change. The term determines the scope of application of a number of provisions that regulate governing documents. If a developer could draft a declaration to exclude certain documents from the definition of "governing documents," legislative policy could be circumvented. For example, proposed Section 4525, which continues existing Section 1368(a), requires that a person selling a separate interest provide the prospective purchaser with "a copy of all governing documents." It would not be good policy to allow the declaration to exclude certain governing documents from that disclosure requirement.

Condominium Plans

The RPLS Working Group suggests adding "condominium plan" to the illustrative list of governing document types. See Memorandum 2010-36, Exhibit p. 121.

The staff is not certain that this would be an appropriate change. It is true that condominium plans have many characteristics of governing documents. A

condominium plan defines important fundamental aspects of a condominium project.

However, the substantive element of the definition of "governing documents" refers to documents that "govern the *operation* of the common interest development or association." A condominium plan specifies the *property boundaries* within a condominium project. See proposed Section 4120. It is not clear to the staff that a document specifying property boundaries governs the *operation* of the CID or its association.

If a condominium plan is covered by that substantive element of the definition, then there is no need to add "condominium plan" to the illustrative list (which is not exclusive). However, if the substantive element of the definition does not cover a "condominium plan," then adding the term to the illustrative list would be a substantive change.

Because of uncertainty on that point, the staff recommends preserving the existing language without change. That might represent a missed opportunity for clarification, but it avoids any chance of inadvertent substantive change.

Technical Suggestion

The Real Property Law Section Working Group suggests deleting the words "of the association" from the phrase "operating rules of the association." See Memorandum 2010-36, Exhibit p. 121.

The staff recommends that this change be made. The words are unnecessary and the change would be consistent with other simplifying revisions made elsewhere in the proposed law. See, e.g., proposed Section 5115(b).

"MAJOR COMPONENT" DEFINED

The McPherson Group suggests adding a new definition, of the term "major component." See Memorandum 2010-36, Exhibit p. 18. That term is used in provisions that relate to reserve funding. For example, the reserve study that must be prepared pursuant to proposed Section 5555, is limited to the "major components" of the association.

The staff agrees that it would be very helpful to define this key term. **However, this issue would be better addressed as part of a separate study of association accounting provisions.**

"MANAGING AGENT" DEFINED

Proposed Section 4155 would provide a general definition of the term "managing agent" for use in all provisions of the Davis-Stirling Act:

> 4155. (a) A "managing agent" is a person who, for compensation or in expectation of compensation, exercises control over the assets of a common interest development.
>
> (b) A "managing agent" does not include any of the following:
>
> (1) A full-time employee of the association.
>
> (2) A regulated financial institution operating within the normal course of its regulated business practice.
>
> (3) An attorney at law acting within the scope of the attorney's license.

The definition would combine the substance of two existing definitions of the term "managing agent." See existing Sections 1363.1(b), 1363.2(f). Those provisions are substantively the same, except that Section 1363.1(b) does not include the attorney exception stated in proposed Section 4155(b)(3).

The Real Property Law Section Working Group raises a number of objections to the proposed generalization of the definition.

☞ Objection to Merged Definition

First, the RPLS Working Group asserts that the difference between the definitions used in existing Sections 1363.1 and 1363.2 is intentional and should be preserved. The staff does not understand that assertion.

The only substantive difference between the two definitions is that Section 1363.1 does not include the exception for the association's attorney. This suggests that the RPLS Working Group believes that association attorneys are subject to the requirements of Section 1363.1. That would be surprising, as Section 1363.1 seems only to have relevance when selecting property manager.

The staff would appreciate receiving input on that issue. Do attorneys comply with Section 1363.1 before commencing work for an association? If not, why would it be a problem to exempt attorneys from the definition of "managing agent" as used in that provision?

☞ Objection to Generalized Definition

Generalization of the definition of "managing agent" would result in the proposed definition being applied to a handful of provisions that currently use the term without any definition. See Sections 4210 (recorded notice of agent

authorized to receive payments), 4280 (content of articles of incorporation), 4815 (comparative fault), 4930 (conduct of board meetings), 5405 (state registry).

The Real Property Law Section Working Group objects to that change in the law. See Memorandum 2010-36, Exhibit p. 121.

The group does not seem to object to the main substance of the definition, provided in proposed Section 4155(a): "A 'managing agent' is a person who, for compensation or in expectation of compensation, exercises control over the assets of a common interest development."

Rather, the group seems to be concerned about generalizing the exceptions to that definition, which are provided in proposed Section 4155(b) (i.e., the exceptions for a full-time employee of the association, a financial institution, and the association's attorney). In particular, they are concerned about exempting a full-time employee from the definition of "managing agent." See Memorandum 2010-36, Exhibit p. 121.

One way of addressing this concern would be to preserve the limited application of the definition, so that it would not apply to any new provision. That would be a missed opportunity, as there seems to be real potential for confusion and ambiguity as to the meaning of "managing agent" in the provisions that do not define it.

Would generalization of the exceptions cause problems in the provisions that currently use the term without definition? The staff will examine each such provision in turn:

Proposed Section 4205 permits an association to record notice of the person who is authorized to receive assessment payments on behalf of the association. That person can include the "managing agent," but it can also include any "other individual or entity." Because of that unrestricted catch-all, any narrowing of the meaning of "managing agent" would have no effect. **The staff sees no problem that could result from application of the generalized definition to this provision.**

Proposed Sections 4280 and 5405 require that the association name its managing agent (if any) in its articles and in the state registry of CIDs, respectively. In those provisions, it may be *best* to exclude the association's employees from the disclosure requirement. While there is value in identifying a third party who has contracted to act as the association's agent, there would seem to be less value in listing all full time management employees of the association. **However, if the Commission disagrees, Sections 4280 and 5405**

could be revised to refer to a "managing agent or full-time employee manager."

Proposed Section 4930, relating to the conduct of board meetings, does not require any adjustment to conform to the generalized definition, because it already expressly refers to a managing agent, "other agent of the board," "or staff." (Incidentally, that language suggests that the Legislature does not read "managing agent" to include employees.)

Finally, proposed Section 4815 continues existing rules on comparative fault when an association brings an action in its own name for damage to the CID. The section provides:

> 4815. (a) In an action maintained by an association pursuant to subdivision (b), (c), or (d) of Section 4810, the amount of damages recovered by the association shall be reduced by the amount of damages allocated to *the association or its managing agents* in direct proportion to their percentage of fault based upon principles of comparative fault. The comparative fault of *the association or its managing agents* may be raised by way of defense, but shall not be the basis for a cross-action or separate action against *the association or its managing agents* for contribution or implied indemnity, where the only damage was sustained by the association or its members. It is the intent of the Legislature in enacting this subdivision to require that comparative fault be pleaded as an affirmative defense, rather than a separate cause of action, where the only damage was sustained by the association or its members.
>
> (b) In an action involving damages described in subdivision (b), (c), or (d) of Section 4810, the defendant or cross-defendant may allege and prove the comparative fault of *the association or its managing agents* as a setoff to the liability of the defendant or cross-defendant even if the association is not a party to the litigation or is no longer a party whether by reason of settlement, dismissal, or otherwise.
>
> (c) Subdivisions (a) and (b) apply to actions commenced on or after January 1, 1993.
>
> (d) Nothing in this section affects a person's liability under Section 1431, or the liability of *the association or its managing agent* for an act or omission that causes damages to another.

(Emphasis added.)

Section 4815 repeatedly refers to the "comparative fault of the association or its managing agents." If "managing agents" is defined to exclude full time employees, would that change the substance of the provision? In other words, should the provision be read to include full time employees of the association in

the term "managing agents?" The staff could not find any court decision addressing that issue.

For the policy purposes of Section 4815, the staff sees no reason to treat the comparative fault of an association's employees any differently from the comparative fault of the association's non-employee agents.

It may be that the identity between the association and its employees is so close, that references to the comparative fault of the association are understood to include the comparative fault of its employees. Under that reading, exclusion of employees from the definition of "managing agent" would not cause any substantive change in the meaning of proposed Section 4815.

However, it is not certain the provision would be read that way. It is therefore possible that exclusion of employees from the definition of "managing agent" could be understood to exclude employees from Section 4815. Of course, it is also the case that readers of the existing language would be uncertain as to whether or not the provision applies to employees.

It would be best to eliminate any uncertainty. That could be achieved by revising Section 4815 to refer to "the association, its employees, or its managing agents" throughout.

As this issue is substantively significant, the staff requests public comment before making any final recommendation on the point.

Technical Suggestion

The McPherson Group suggests a technical revision of the definition, to improve its accuracy:

> 4155. (a) A "managing agent" is a person who, for compensation or in expectation of compensation, ~~exercises control over the assets of~~ manages a common interest development.
>
> …

The group's comment suggests that some managing agents do not "exercise control over assets." See Memorandum 2010-36, Exhibit p. 18.

It seems likely that this is correct, and that the more general language suggested by the group would be clearer and less prone to misunderstanding or dispute. **Unless we receive comments arguing for a different result, the staff recommends that the proposed revision be made.**

☞ "MEMBER" DEFINED

Proposed Section 4160 would add a definition of "member," thus:

> 4160. "Member" means either of the following persons:
> (a) An owner of a separate interest.
> (b) A person that is designated as a member in the declaration, articles of incorporation, or bylaws. The incidents of a membership established under this paragraph may be limited by the document that establishes the membership.

The Real Property Law Section Working Group objects to the addition of subdivision (b). That provision, which recognizes that an association may have non-owner members for specifically limited purposes, was added to the first version of the proposed law on the suggestion of Curtis Sproul, an attorney and expert on CID law. See First Supplement to Memorandum 2007-47, pp. 25-26.

The purpose of the added language was to ensure that non-owner members were not excluded from any statutory provisions that facilitate the exercise of their rights and the protection of their interest in the association (e.g., a non-owner member who is entitled to vote in an election should receive the same ballot materials sent to all other members.).

These non-owner members would not be affected by provisions that relate to property ownership and use, but would benefit from application of the provisions relating to governance of the association (e.g., they would receive all individual notices and annual reports, and could attend meetings, participate in the association's internal dispute resolution process, and inspect records.)

With that explanation in mind, the staff invites further comment on whether the non-owner member provision should be deleted or substantially revised.

(If the provision is retained, the Real Property Law Section Working Group suggests that it be revised to authorize designation of non-owner members in the articles of association, as well as the articles of incorporation. See Memorandum 2010-36, Exhibit p. 121. This would treat incorporated and unincorporated associations in the same way. **The staff believes that would be an improvement.**)

"OCCUPANT" DEFINED

As noted above, the proposed law would standardize terminology by replacing all use of the term "resident" with the term "occupant." An existing

definition of "occupant" (in Section 1364(e)) would then be generalized in proposed Section 4163, thus:

> 4163. "Occupant" means an owner, resident, guest, invitee, tenant, lessee, sublessee, or other person in possession of a separate interest.

Comments on those changes are discussed below.

☞ **Generalization of Definition**

The Real Property Law Section Working Group is concerned that the application of the generalized definition could cause disputes or inappropriately extend statutory duties to new classes of persons. See Memorandum 2010-36, Exhibit p. 122.

The staff sees greater scope for disputes under existing law, which uses undefined terms, than under the proposed law. For example, suppose that a separate interest is rented to short-term vacationers. Are those vacationers "occupants?" Under the proposed definition, the answer would be clear. The vacationers would be lessees in possession of the property and would be "occupants." Without the definition, different people could construe the term "occupant," differently.

Would a generalized definition inappropriately extend the scope of statutory duties or rights?

It seems clear that the terms "resident" and "occupant" should encompass tenants and guests or family members of the owner who actually reside in the separate interest. The more difficult question involves business invitees and nonresident guests, both of which are included in the proposed definition.

In the staff's view, those types of persons would not create any problems with respect to the following sections that use the term "occupant":

- Proposed Section 4110 (defining "community service organization" as a specified type of organization that provides services to owners and occupants of a CID)
- Proposed Section 4510 (guaranteeing owner and occupant access to a separate interest)
- Proposed Section 4760 (precluding modification of separate interest that unreasonably impairs passage of other occupants)
- Proposed Sections 5725 and 5860 (liability of owner for violation of restrictions by occupant of owner's separate interest)

The only provision that might cause problems in this context is proposed Section 4930, which would specify certain rights of owners and occupants to speak at board meetings. On this point, Kazuko Artus suggests that an owner's child or live-in domestic servant should not be permitted to speak at a board meeting, except as the owner's designated representative. See Memorandum 2010-36, Exhibit p. 53. Similarly, some might object to business invitees of an owner being permitted to speak at a board meeting. For example, suppose that an owner operates a home day care out of his or her separate interest. The board is contemplating a rule change that would have a negative effect on the clients of that business. They wish to speak at the board meeting to express their views on the rule change. Should Section 4930 apply to those invitees?

The Commission should consider whether to limit the scope of the term as used in proposed Section 4930 (board meeting testimony). Other than that, the staff believes that the proposed definition would generally be an improvement. It would standardize and define language, without causing serious problems as a result.

Nonresident Owner

Kazuko Artus suggests that nonresident owners should not be treated as "occupants." See Memorandum 2010-36, Exhibit p.53. **In light of the analysis of the sections that use the term "occupant," summarized above, the staff does not see any problem that would result from including owners in the definition.**

Technical Drafting Suggestions

Both the McPherson Group and Kazuko Artus suggest revising the provision to make clear that mere possession is not enough to be considered an occupant. *Lawful* possession should be required. See Memorandum 2010-36, Exhibit pp. 19, 53. **The staff agrees and recommends that the change be made.**

The McPherson Group also suggests revising the list of persons deemed to be occupants as follows: "~~resident, guest,~~ invitee, tenant, ~~lessee, sublessee,~~ subtenant…." See Memorandum 2010-36, Exhibit p. 19.

The proposed deletion of "resident" and "guest" appears to be premised on the idea that those terms are subsumed within "invitee" and therefore surplus. **That makes sense, but nonetheless, the staff recommends against deleting the terms.** The terms are probably much more familiar to non-lawyers than "invitee," and could well help a lay reader understand the intended meaning of

the provision. Also, deletion of the terms might be misconstrued as an intentional narrowing of the scope of the provision.

The suggested changes to the terms "lessee, and sublessee" would make the language flow better, but it seems likely that many non-lawyers have heard of "subletting" and would therefore be more likely to understand "sublessee" than "subtenant." **For that reason, the staff recommends against making those changes.**

Ms. Artus suggests adding "of a separate interest" after sublessee, to make clear that all of the terms listed in the definition are intended to relate to a separate interest. See Memorandum 2010-36, Exhibit p. 53. **The staff does not see the need.** The catch-all at the end of the definition "or other person in possession of a separate interest" would seem to make that meaning clear.

Ms. Artus also suggests adding a definition of the term "invitee." *Id.* **The staff recommends against doing so.** Its meaning seems sufficiently clear in context. Any attempt to add a statutory definition would run the risk of unintended limitation or other change.

☞ "OPERATING RULE" DEFINED

Proposed Section 4165 would generalize the existing definition of "operating rule" without substantive change, as follows:

> 4165. "Operating rule" means a regulation adopted by the board that applies generally to the management and operation of the common interest development or the conduct of the business and affairs of the association.

The Real Property Law Section Working Group writes that this existing definition causes problems, to the extent that it includes written procedures affecting the internal operation of the association. See Memorandum 2010-36, Exhibit p. 123. They propose that the definition be reframed, so that it only relates to rules that affect

> the use of an owner's separate interest or the common area or that [affect] the relationship between a member and an association with respect to that member's rights or responsibilities.

Id.

In order to evaluate this suggestion, it is helpful to recall the substantive effects of the definition: (1) it defines the scope of application of the rulemaking

procedure, and (2) it defines the scope of application of provisions governing disclosure of the governing documents.

Regarding the first effect, the proposed change would not seem to be needed. That is because the application of the rulemaking procedure is primarily determined by another provision, proposed Section 4355. Subdivision (a) of that section limits the scope of the rulemaking procedure to operating rules addressing the following topics:

> (1) Use of the common area or of an exclusive use common area.
> (2) Use of a separate interest, including any aesthetic or architectural standards that govern alteration of a separate interest.
> (3) Member discipline, including any schedule of monetary penalties for violation of the governing documents and any procedure for the imposition of penalties.
> (4) Any standards for delinquent assessment payment plans.
> (5) Any procedures adopted by the association for resolution of disputes.
> (6) Any procedures for reviewing and approving or disapproving a proposed physical change to a member's separate interest or to the common area.
> (7) Procedures for elections.

All of those subjects seem to be in accord with the language proposed by the Real Property Law Section Working Group. Consequently, the proposed change to the definition of "operating rule" would not seem to have any effect on the scope of the rulemaking procedure.

The other main effect of the definition is in defining the scope of documents that are subject to member inspection and disclosure to prospective purchasers. See proposed Sections 4525(a), 5200(a)(11).

As those provisions require the inspection and disclosure of *all governing documents*, and the definition of "governing documents" includes any document that governs the operation of a CID, the proposed narrowing of the definition of "operating rule" would not seem to have any effect on the scope of required inspection and disclosure. Anything that was carved out of the definition of "operating rule" would seem to fall into the broader category of "governing documents."

Because the proposed revision would not seem to have any effect on the provisions that use the defined term, the staff recommends that the existing language be preserved.

"PERSON" DEFINED

Proposed Section 4170 would add a definition of "person," in order to make clear that the term includes legal entities:

> 4170. "Person" means an individual, corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership, limited liability company, association, or other entity.

The McPherson Group suggests replacing "individual" with "natural person," for conformity with another provision that uses that term (proposed Section 4140 ("director" defined)). See Memorandum 2010-36, Exhibit p. 19.

That change would improve the uniformity of language used in the proposed law, without affecting the substantive meaning of the proposed definition. The term "natural person" is also used in defining "person" in Section 14. **The staff recommends that the proposed change be made.**

"PLANNED DEVELOPMENT" DEFINED

Proposed Section 4175 would continue the existing definition of "planned development," without substantive change:

> 4175. "Planned development" means a development (other than a community apartment project, a condominium project, or a stock cooperative) having either or both of the following features:
>
> (a) The common area is owned either by an association or in common by the owners of the separate interests who possess appurtenant rights to the beneficial use and enjoyment of the common area.
>
> (b) A power exists in the association to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of the common area by means of an assessment that may become a lien upon the separate interests in accordance with Article 5 (commencing with Section 5650) of Chapter 7.

The RPLS Working Group and the McPherson Group both suggested revisions to the definition.

Technical Amendments: RPLS Working Group

The RPLS Working Group proposes the following revisions:

> 4175. "Planned development" means a <u>common interest</u> development (other than a community apartment project, a condominium project, or a stock cooperative) having <u>a recorded declaration and</u> either or both of the following features:

(a) The common area is owned either by an association or in common by the owners of the separate interests who possess appurtenant rights to the beneficial use and enjoyment of the common area.

(b) A power exists pursuant to a recorded declaration in the association to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of the common area by means of an assessment that may become a lien upon the separate interests in accordance with Article 5 (commencing with Section 5650) of Chapter 7.

See Memorandum 2010-36, Exhibit p. 124.

The staff is not convinced of the benefit of the first suggested revision. Recall that the term "common interest development" is defined as either a community apartment project, condominium project, planned development or stock cooperative. See proposed Section 4100. To then define "planned unit development" as a type of common interest development seems circular. **The staff recommends against making that change.**

Nor is the staff convinced of the need for the second proposed revision. By law, the Davis-Stirling Act only applies to a CID that has a recorded declaration. See proposed Section 4030(a)(1). For that reason, the proposed new language seems redundant. What's more, unless parallel changes are made to the definitions of community apartment project, condominium project, and stock cooperative, the insertion of the language in this provision could create a problematic inference (that recorded declarations are not required in those other types of CID).

The final proposed revision raises a substantive question — can the requisite power be created in a document other than a declaration? **The staff recommends that this question be included in a study of CID formation questions and not addressed in the current proposal.**

Technical Amendments: McPherson Group

The McPherson Group suggests revising the definition as follows:

4175. "Planned development" means real property ~~a development~~ (other than a community apartment project, a condominium project, or a stock cooperative) having either or both of the following features:

(a) ~~The common area~~ Common area that is owned either by an association or in common by the owners of the separate interests who possess appurtenant rights to the beneficial use and enjoyment of some or all of the common area.

(b) ~~A power exists in the association to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of the common area by means of an assessment~~ Common area and an association that maintains the common area with the power to levy assessments that may become a lien upon the separate interests in accordance with Article 5 (commencing with Section 5650) of Chapter 7.

See Memorandum 2010-36, Exhibit pp. 19-20.

Regarding the first proposed revision, in the introductory clause, the staff is unsure that "real property" is a sufficiently complete substitute for the term "development." It might be better to instead combine the language to read: "a real property development." That would be consistent with a proposed revision in the definition of "condominium project," discussed above. **The staff recommends that approach.**

The second proposed revision, to reword the beginning of subdivision (a), would not seem to have any substantive effect. **The staff agrees that the revised language would read more cleanly and recommends that the change be made**.

The staff is unsure of the benefit of the proposed insertion of "some or all" in subdivision (a). **Unless we receive a fuller explanation of the reason for that proposed change, the staff would recommend preserving existing language on that point.**

Finally, the staff believes that the proposed restatement of the first part of subdivision (b) would make the provision much easier to understand. The proposed revision would not appear to change the meaning of the provision. **Unless we receive comments to the contrary, the staff recommends making the proposed change.**

Scope of Definition

The RPLS Working Group suggests that the definition be refined to better conform its scope to recent court decisions on the issue. See Memorandum 2010-36, Exhibit p. 124. This issue involves the complexities of CID formation. **It should be studied separately in connection with other similar formation issues.**

"RESERVE ACCOUNT" DEFINED

Proposed Section 4177 would continue an existing definition of "reserve account" without substantive change, but would generalize its application so that it applies to the entire Act:

> 4177. "Reserve accounts" means both of the following:
> (a) Moneys that the board has identified for use to defray the future repair or replacement of, or additions to, those major components that the association is obligated to maintain.
> (b) The funds received, and not yet expended or disposed of, from either a compensatory damage award or settlement to an association from any person for injuries to property, real or personal, arising from any construction or design defects. These funds shall be separately itemized from funds described in subdivision (a).

Comments on that definition are discussed below.

"Account" v. "Fund"

Both Kazuko Artus and the RPLS Working Group suggest that it is not ideal for the term "account" to be used in defining a type of money or funds. See Memorandum 2010-36, Exhibit pp. 55, 125.

The RPLS Working Group suggests that the definition should be split into two definitions. "Reserve fund" would define the type of funds described in proposed Section 4177. "Reserve account" would mean the account in a financial institution account where reserve funds are held.

That seems sensible on the surface. However, the staff has previously received input suggesting that some associations combine operating funds and reserve funds into a single bank account, but track the funds separately in their accounting records. The proposed change might interfere with that practice unnecessarily.

The staff recommends that this issue be considered as part of a separate study of all accounting issues.

"Reserve" Disfavored

Ms. Artus suggests that the term "reserves" should not be used, as it is falling into disfavor in the accounting industry. See Memorandum 2010-36, Exhibit p. 55. **Again, the staff believes that issues relating to accounting terminology should be considered as part of a separate study.**

Generalization Problematic

Ms. Artus also finds the definition to be confusing. In particular, she examined each section that uses the term "reserve account" and substituted the full definition for the defined term. When she did this, the provisions read awkwardly. For example, she writes:

> Proposed § 5510(a) would read as follows when the proposed definition is substituted for "reserve accounts":
>
> > The signature of at least two persons, who shall be directors, or one officer who is not a director and a director, shall be required for the withdrawal of moneys from the association's moneys that the board has identified for use to defray the future repair or replacement of, or additions to, those major components that the association is obligated to maintain and/or the funds received, and not yet expended or disposed of, from either a compensatory damage award or settlement to an association from any person for injuries to property, real or personal, arising from any construction or design defects.
>
> (Language of the proposed definition underlined.) What does the "withdrawal of moneys from the association's moneys" or the "withdrawal of moneys from the funds . . ." mean?

Id.

The staff does not believe that is the best way to evaluate the usefulness of a definition. It is often true that substituting a full definition for a defined term will produce awkward language. That is one of the principal benefits of using defined terms. It permits the simplification of otherwise complex language.

Although the substituted language set out above does read awkwardly, its meaning seems sufficiently clear. The provision imposes formalities on the withdrawal of certain funds. Those funds are described in the term "reserve account."

The staff does not see any substantive problem that would result from generalizing the definition. By contrast, the failure to generalize the definition would preserve existing ambiguity on how to construe the term where it is used without definition. **On balance, the staff believes that the generalization is helpful and should be retained.**

Maintenance Terminology

The RPLS Working Group notes that a number of provisions use similar, but slightly different language in describing the repair and maintenance obligations

of an association. They suggest that the language be standardized. See Memorandum 2010-36, Exhibit p. 125.

That suggestion seems sensible. However, the suggestion would probably be best analyzed in the context of substantive provisions relating to repair and maintenance. **The issue will be examined in a later memorandum considering property maintenance.**

"RESERVE ACCOUNT REQUIREMENTS" DEFINED

Proposed Section 4178 would continue an existing definition of "reserve account requirements" without substantive change, but would generalize its application so that it applies to the entire Act:

> 4178. "Reserve account requirements" means the estimated funds that the board has determined are required to be available at a specified point in time to repair, replace, or restore those major components that the association is obligated to maintain.

Ms. Artus and the RPLS Working Group make the same comments on this provision that were made regarding proposed Section 4177. See Memorandum 2010-36, Exhibit pp. 55, 126. See that discussion.

"RULE CHANGE" DEFINED

Proposed Section 4178 would continue the existing definition of "rule change" without substantive change, but would generalize its application so that it applies to the entire act:

> 4180. "Rule change" means the adoption, amendment, or repeal of an operating rule by the board.

The RPLS Working Group suggests adding a sentence to remind readers that "Many rule changes are subject to the provisions of Sections 4355 through 4370." See Memorandum 2010-36, Exhibit p. 126. Those are the sections that govern operating rule content and the rulemaking process.

The staff is not convinced of the benefit of adding that purely advisory language. The term "rule change" is only used in the referenced sections. Presumably, if a reader needs to know the meaning of the term, it is because the reader is already aware of the sections that use the term.

Furthermore, once one begins adding language of this type, which is not legally operative and exists only to educate the reader about other provisions,

there is no obvious stopping point. A similar advisory statement could be added to the definitions of "operating rule," and "governing documents." Or proposed Section 4178 could be revised to advise readers that the board must comply with open meeting requirements. And so on.

The staff recommends against adding the proposed language.

"SEPARATE INTEREST" DEFINED

Proposed Section 4185 would continue the existing definition of "separate interest" without substantive change:

> 4185. (a) "Separate interest" has the following meanings:
> (1) In a community apartment project, "separate interest" means the exclusive right to occupy an apartment, as specified in Section 4105.
> (2) In a condominium project, "separate interest" means an individual unit, as specified in Section 4125.
> (3) In a planned development, "separate interest" means a separately owned lot, parcel, area, or space.
> (4) In a stock cooperative, "separate interest" means the exclusive right to occupy a portion of the real property, as specified in Section 4190.
> (b) Unless the declaration or condominium plan, if any exists, otherwise provides, if walls, floors, or ceilings are designated as boundaries of a separate interest, the interior surfaces of the perimeter walls, floors, ceilings, windows, doors, and outlets located within the separate interest are part of the separate interest and any other portions of the walls, floors, or ceilings are part of the common area.
> (c) The estate in a separate interest may be a fee, a life estate, an estate for years, or any combination of the foregoing.

Commenters have suggested a few technical revisions to that provision, which are discussed below.

In subdivision (a)(2), the McPherson Group suggests replacing "individual unit" with "a separately owned unit." See Memorandum 2010-36, Exhibit p. 21. That would parallel the equivalent language in subdivision (a)(3). **As this revision would not have any apparent effect on the substance of the provision, but would increase the uniformity of language used in parallel provisions, the staff recommends that it be made.**

In subdivision (a)(3), the RPLS Working Group questions whether it is necessary to include "area, or space." See Memorandum 2010-36, Exhibit p. 126.

Absent certainty that the language is unnecessary, the staff recommends against its deletion.

In subdivision (c), the McPherson Group suggests beginning the sentence with "an" rather than "the." See Memorandum 2010-36, Exhibit p. 21. **The staff does not see the benefit of changing existing language on that point.**

"STOCK COOPERATIVE" DEFINED

Proposed Section 4190 would continue the existing definition of "stock cooperative" without substantive change:

> 4190. (a) "Stock cooperative" means a development in which a corporation is formed or availed of, primarily for the purpose of holding title to, either in fee simple or for a term of years, improved real property, and all or substantially all of the shareholders of the corporation receive a right of exclusive occupancy in a portion of the real property, title to which is held by the corporation. The owners' interest in the corporation, whether evidenced by a share of stock, a certificate of membership, or otherwise, shall be deemed to be an interest in a common interest development and a real estate development for purposes of subdivision (f) of Section 25100 of the Corporations Code.
>
> (b) A "stock cooperative" includes a limited equity housing cooperative which is a stock cooperative that meets the criteria of Section 817.

Comments on that provision are discussed below.

"Interest" in Real Estate Development

The McPherson Group suggests revising the last sentence of subdivision (a) as follows:

> The owners' interest in the corporation, whether evidenced by a share of stock, a certificate of membership, or otherwise, shall be deemed to be an interest in a common interest development and <u>shall be</u> a real estate development for purposes of subdivision (f) of Section 25100 of the Corporations Code.

See Memorandum 2010-36, Exhibit p. 21. **The staff recommends against that change.**

The existing language provides that the owner's interest in the corporation is "*an interest in* … a real estate development" for the purposes of Corporations Code Section 25100(f). (Emphasis added.) That makes sense, as Section 25100(f) provides an exception for an "interest in … a real estate development."

The proposed revision would seem to change the substantive meaning of the provision, in a way that would be at odds with the cross-reference to Section 25100(f). It would make an interest in the corporation "a real estate development," rather than *an interest in* a real estate development.

For Profit Status

David Noble suggests that the reference, in the second sentence of subdivision (a), to a "share of stock" is at odds with the requirement that the association be organized as a nonprofit corporation. See proposed Section 4080 ("association" defined). See Memorandum 2010-36, Exhibit pp. 63-64. The RPLS Working Group raises the same issue and also renews its concern about the status of a stock cooperative that lacks a recorded declaration. See Memorandum 2010-36, Exhibit p. 127.

The staff recommends that these issues be studied separately in connection with a broader study of CID formation issues.

PROPOSED NEW DEFINITIONS

The RPLS Working Group suggests the addition of a number of new definitions, to make the proposed law easier to use. Some of those suggestions have already been discussed and are not discussed again here. The remaining suggestions are analyzed below:

Alternative Dispute Resolution

The RPLS Working Group suggests adding a definition of "alternative dispute resolution" that would refer to the procedures governed by proposed Sections 5925 through 5965. See Memorandum 2010-36, Exhibit pp. 127-28.

The staff recommends against doing so, for three reasons:

(1) There is already a definition of the term "alternative dispute resolution," which governs the referenced provisions. See proposed Section 5925(a).

(2) Every provision of the proposed law that uses the term either includes a cross-reference to the relevant provisions (see proposed Sections 5310, 5660, 5705, 5730, 5900) or is not clearly limited to the ADR process described in the referenced provisions (see proposed Sections 5685, 6000).

(3) Although it appears that the proposed definition is meant to reiterate the existing definition provided in proposed Section 5925(a), it uses substantively different language.

☞ **Annual Budget Report**

The RPLS Working Group suggests adding a definition of "annual budget report," which would simply direct the reader to proposed Section 5300 (which states the delivery and content requirements for that report). See Memorandum 2010-36, Exhibit p. 128.

The definition is not strictly necessary. Every provision of the proposed law that references the annual budget report includes a cross-reference to proposed Section 5300. See proposed Sections 5570, 5610, 5810.

That said, the staff sees no harm that would result from adding the proposed definition. It might help readers find the controlling provision. **Should such a provision be added?**

☞ **Annual Policy Statement**

The RPLS Working Group suggests adding a definition of "annual policy statement," which would simply direct the reader to proposed Section 5310 (which states the delivery and content requirements for that report). See Memorandum 2010-36, Exhibit p. 128.

This suggestion raises the same issues as described above, in connection with the proposed definition of "annual budget report." Every provision of the proposed law that references the term includes a cross-reference to the controlling provision. See proposed Sections 4035, 4045, 4950, 5675, 5730, 5850, 5920, 5965.

Should such a provision be added?

Common Expenses

The RPLS Working Group suggests adding the following definition of the term "common expenses":

> "Common expenses" means any use of association funds authorized by the governing documents or required or permitted by law.

The defined term is not used in any provision of the proposed law. However, it would be used in the definition of "regular assessment" proposed by the RPLS Working Group. As discussed below, the staff recommends against adding that definition to the proposed law. **If the Commission agrees with that recommendation, the proposed definition of "common expenses" would have no application and should not be added to the proposed law.**

Corporations Code

The RPLS Working Group suggests adding the following provision (which might be more properly framed as a rule of construction than a definition):

> References in this Act to the Corporations Code are generally to provisions of the Nonprofit Mutual Benefit Corporation Law, commencing at Section 7110 of the Corporations Code, unless the context clearly indicates otherwise. If an incorporated association is instead organized under the Nonprofit Public Benefit Corporation Law, commencing at Section 5110 of the Corporations Code, the corresponding provisions of the Nonprofit Public Benefit Corporation Law are intended to apply in that circumstance.

The staff recommends against adding the proposed provision, for the following reasons:

(1) *It isn't clear that the provision is needed.* Only one provision of the proposed law references the Corporations Code without specifying a particular provision of that code. See proposed Section 5110 (requiring that elections be conducted in compliance with "this article, the Corporations Code, and all applicable rules of the association regarding the conduct of the election that are not in conflict with this article.").

(2) *In some cases, the provision might be confusing.* There are three provisions that refer to Corporations Code provisions that are not part of the Nonprofit Mutual Benefit Corporation Law or the Nonprofit Public Benefit Corporation Law. See proposed Sections 4190, 4280, 5580. Application of the proposed rule of construction to those provisions would be unhelpful at best, and could be confusing.

(3) *In some cases, the provision might create inadvertent substantive change.* Many provisions of the mutual benefit and public benefit nonprofit corporation laws are substantively identical. In those cases, it is not important which provision is read and followed, as the outcome would be the same. But in some cases, there may be substantive differences. In those cases, treating a reference to a mutual benefit provision as if it were a reference to the "corresponding" public benefit provisions could lead to a difference in outcome. The staff is reluctant to risk such a result without much greater study than is practical in the present context. (As an aside, requiring a layperson to determine what provision of the public benefit corporation law "corresponds" to a specified mutual benefit provision would itself create scope for confusion and mistake.)

Dispute Resolution

The RPLS Working Group proposes adding a definition of "dispute resolution" that would encompass both the internal dispute resolution procedure governed by proposed Sections 5900-5920 and the ADR procedures governed by proposed Sections 5925-5965.

The staff recommends against making this change. Nearly all provisions that use the term already contain cross-references to the relevant sections. The exceptions are in provisions that are not clearly intended to be limited to the provisions referenced in the proposed definition. See, e.g., proposed Sections 5905, 6000.

☞ **General Notice**

The RPLS Working Group suggests adding a definition of "general notice," which would simply direct the reader to proposed Section 4045. See Memorandum 2010-36, Exhibit p. 128.

The definition is not strictly necessary. Every provision of the proposed law that references general notice includes a cross-reference to proposed Section 4045.

That said, the staff sees no harm that would result from adding the proposed definition. It might help readers find the controlling provision. **Should such a provision be added?**

☞ **Individual Notice**

The RPLS Working Group suggests adding a definition of "general notice," which would simply direct the reader to proposed Section 4040. See Memorandum 2010-36, Exhibit p. 128.

The definition is not strictly necessary. Every provision of the proposed law that references general notice includes a cross-reference to proposed Section 4040.

That said, the staff sees no harm that would result from adding the proposed definition. It might help readers find the controlling provision. **Should such a provision be added?**

Meet And Confer Program

The RPLS Working Group suggests adding a definition of "meet and confer program," as follows:

> "Meet and confer program" means an association's program of internal dispute resolution that is available to owners and the association, in which the parties meet informally in an effort at early intervention to resolve differences. The statutory requirements for a meet and confer program are set forth in Sections 5900 through 5920.

See Memorandum 2010-36, Exhibit p. 129.

As with many of the suggestions discussed above, it is not clear that the suggested addition is strictly necessary. Every provision of the proposed law that refers to the referenced program already includes a specific statutory reference to the relevant provisions.

What's more, it may be misleading to describe the internal dispute resolution program as a "meet and confer" program. Existing law requires that an association provide an internal dispute resolution procedure that meets the minimum standards set out in proposed Section 5910. Nothing in that section limits an association to using a meet and confer process for the resolution of disputes. The "meet and confer" procedure is a statutory default procedure that applies only if the association has not adopted a procedure of its own. See proposed Section 5915.

Because the definition is not strictly necessary, and might be misleading, the staff recommends against adding it.

Monetary Penalty

The RPLS Working Group suggests adding a definition of the term "monetary penalty," as follows:

> "Monetary penalty" means a fine imposed by an association against an owner and the owner's separate interest for failure to comply with the governing documents or this Act. A monetary penalty may only be imposed if an association has adopted and provided general notice of a schedule of monetary penalties as set forth in Section 5850 and following notice and hearing as defined in Section _____.

See Memorandum 2010-36, Exhibit p. 129.

The staff recommends against adding that provision.

The first sentence is not strictly necessary, as the plain meaning of the term is fairly clear, especially in the context in which the term is used.

The second sentence is too substantive for inclusion in a definition. It states a rule, not part of the definition of the term. What's more, it could potentially be

misleading as it paraphrases only part of what is required before a monetary penalty may be imposed.

Nonresidential Development

The RPLS Working Group suggests adding a general definition of the term "nonresidential association." That term is only used in one provision, which already adequately defines the concept. See proposed Section 4025 (which would be renumbered as proposed Section 4202). What's more, the definition is the subject of a currently pending separate study. **The staff recommends against making any change to the treatment of nonresidential developments in this proposed law.**

Notice And Hearing

The RPLS Working Group proposes adding the following definition of the term "notice and hearing":

> "Notice and hearing" means the due process procedures for notifying an owner of potential discipline against that owner and providing the owner with an opportunity to meet with the board before such discipline may be imposed, as more fully set forth in Section 5855.

See Memorandum 2010-36, Exhibit p. 129.

The term "notice and hearing" is not used in any provision of the proposed law. Furthermore, it is an incomplete paraphrase of the substance of other law, rather than a true definition. **The staff recommends against adding this provision.**

☞ **Record, Recordation, Recording**

The RPLS Working Group suggests adding a definition of the terms "record," "recordation," and "recording" as follows:

> "Record," "Recordation" and "Recording" mean, with respect to any document that is required by law to be recorded with the county recorder in order to have legal effect, the recordation or filing of such document in the office of the county recorder of each county in which any portion of the common interest development is located.

See Memorandum 2010-36, Exhibit p. 130.

The staff sees merit in making clear that "recording" a document means recording it at the county recorder's office for any county in which the CID is located. However, the provision should probably be simplified, thus:

> If a provision of this Act provides that a document shall or may be "recorded," that document shall be filed for record in the office of the county recorder of each county in which any portion of the common interest development is located.

Note that this provision is more of a substantive rule than a definition. As such, it should probably be added to the preliminary provisions, rather than in the definitions. It could be added as proposed Section 4055, in which case it would immediately follow the provisions governing notices, which seems appropriate. **Should that revision be made?**

☞ **Regular Assessment & Special Assessment**

The RPLS Working Group suggests adding a definition of the term "regular assessment," as follows:

> "Regular Assessment" means an assessment levied by an association on its members and their separate interests to fund the annual common expenses (Section _____) of the association as estimated in the operating budget adopted pursuant to Section 5300.

See Memorandum 2010-36, Exhibit p. 130.

The group also proposes defining "special assessment," as follows:

> "Special Assessment" means an assessment levied by an association on its members and their separate interests to fund extraordinary, typically non-recurring common expenses resulting from such factors as unanticipated common expenses (Section ____), uninsured losses, major repair, replacement or restoration projects for which reserve requirements have not been adequately funded, or the acquisition, addition or expansion of common area buildings, grounds or facilities. The foregoing description of the sort of common expenses that may be funded by means of a special assessment is intended to be descriptive and not exclusive. An emergency assessment (Section ____) is a special assessment.

Id.

The two proposed provisions are discussed jointly, because taken together, they describe the two alternative types of assessments, regular and special.

In the staff's view, the key difference between regular assessments and special assessments is that regular assessments continue automatically on a

regular periodic basis (e.g., monthly), while a special assessment is a one-time, non-recurring assessment. The proposed definition of "special assessment" captures that distinction, but the proposed definition of "regular assessment" does not.

Instead, the proposed definition of "regular assessment" attempts to define the term by reference to other substantive characteristics of regular assessments (e.g., that they are used to fund annual expenses as estimated in the annual operating budget).

The staff is concerned that an attempt to define "regular assessment" in this way could lead to an inadvertent substantive change in the law. For example, does the proposed reference to "annual" expenses as estimated in the annual budget preclude the use of regular assessments to fund reserves)? It might be read that way, on the grounds that reserve funding is not part of an association's operating expenses.

The staff is unsure whether definitions of "regular assessment" and "special assessment" should be added to the proposed law. However, if definitions are added, the staff would recommend a more conservative approach, based solely on the distinction between recurring and non-recurring assessment. Thus:

> "Regular assessment" means an assessment that is levied on a recurring periodic basis.
>
> "Special assessment" means an assessment levied on a non-recurring basis.

Should such provisions be added to the proposed law?

Respectfully submitted,

Brian Hebert
Executive Secretary