Study H-855 October 11, 2010

First Supplement to Memorandum 2010-48

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

This memorandum presents further public comment and analysis of issues raised in Memorandum 2010-48. The letter from Kazuko K. Artus that is discussed in this memorandum is attached to the First Supplement to Memorandum 2010-47.

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

DOCUMENT AUTHORITY

Memorandum 2010-48 discusses possible changes to proposed Section 4200, a new provision that would provide guidance on the relative authority of the main types of governing documents. (This section would be renumbered as proposed Section 4205, pursuant to a recent decision to create a new chapter in the proposed law. See Minutes (Aug. 2010), p. 4.)

One of the revisions proposed in Memorandum 2010-48 would add an exception to the general rules stated in proposed Section 4205, for a provision of a governing document that is specifically required by law:

> Notwithstanding any other provision of this section, if a provision of a governing document is required by law, with no discretion as to the specific content of the provision, that provision controls over any other inconsistent provision in the governing documents.

In other words, if a statute requires that a provision of a governing document state a specific rule, the mandated provision would not be invalidated by proposed Section 4205, even if the provision is inconsistent with a nominally superior document.

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.

This exception is premised on the notion that the law trumps an association's governing documents, and that this is true regardless of whether the law states a substantive requirement directly (e.g., self-nomination is permitted in board elections) or indirectly (e.g., the association shall adopt an election rule that permits self-nomination). In either case, the substantive legal mandate is the same (self-nomination is permitted). In neither case should the substantive requirement of the law be trumped by an association's governing documents.

This supplement discusses an alternative way to address the issue described above.

Alternative Drafting Approach

In the draft reform set out above, the staff attempted to draw a bright-line distinction between two different scenarios:

> **(1) Non-discretionary content.** A statute requires that an association adopt a governing document provision, *with no discretion as to the substantive effect of the provision*. For example, Section 1363.03(a)(3) requires that an association adopt an operating rule that permits self-nomination for election to the board. The association has no discretion as to that substantive point.
>
> **(2) Discretionary content.** A statute requires that an association adopt a governing document provision on a particular topic, *but does not mandate the substantive content of the provision.* For example, Section 1363.03(a)(4) requires that an association adopt an operating rule stating the qualifications for voting in a CID election, but it does not specify what those qualifications should be.

The proposed exception was drafted to apply only in the first case, where the association has no discretion as to the specific substantive content of a provision.

However, the staff is concerned that this approach might break down if there is more than one way in which an association can comply with a statutory mandate. For example, as mentioned above, an association is required to adopt an election rule that permits self-nomination. The association has no discretion as to that ultimate rule, but there might be discretion on how to achieve the mandated result.

For example, suppose that an association adopts an operating rule that permits self-nomination, but requires that all self-nominations occur at least 30 days before the announced election date. That rule would comply with the specific and non-discretionary requirement of Section 1363.03, that self-nomination be permitted. Now suppose that the association's declaration already

provides that "self-nomination is permitted at any time before an election, including self-nomination from the floor of the meeting at which an election is held."

Would the proposed statutory language encompass the hypothetical operating rule? By its terms, the proposed statutory exception would apply only where an association "has *no* discretion as to the specific content of the provision." (Emphasis added.) In this example, the statute does not grant any discretion as to the mandated result. Nonetheless, the association exercised discretion in determining *how* to reach that result (by requiring nominations at least 30 days before the election). The staff is concerned that the meaning of the proposed language might be unclear in this sort of situation.

After further thought about how to frame the provision, the staff would like to propose an alternative approach. Rather than attempting to draw a bright line distinction between discretionary and non-discretionary mandates, it might be better to instead focus on the core of the problem, the *inconsistency* between governing documents that results from a statutory mandate. For example, the exception could be drafted as in subdivision (e) below:

> 4205. (a) The governing documents may not include a provision that is inconsistent with the law. To the extent of any inconsistency between the governing documents and the law, the law controls.
>
> (b) The articles of incorporation may not include a provision that is inconsistent with the declaration. To the extent of any inconsistency between the articles of incorporation and the declaration, the declaration controls.
>
> (c) The bylaws may not include a provision that is inconsistent with the declaration or the articles of incorporation. To the extent of any inconsistency between the bylaws and the articles of incorporation or declaration, the articles of incorporation or declaration control.
>
> (d) The operating rules may not include a provision that is inconsistent with the declaration, articles of incorporation, or bylaws. To the extent of any inconsistency between the operating rules and the bylaws, articles of incorporation, or declaration, the bylaws, articles of incorporation, or declaration control.
>
> (e) Notwithstanding any other provision of this section, if the law requires that a governing document contain a provision, and compliance with that requirement necessarily creates an inconsistency with another provision of a governing document, the legally required provision controls to the extent of the required inconsistency.
>
> (f) For the purposes of this section, "law" means a statute, agency regulation, ordinance, or final court decision.

Comment. Section 4205 is new.

Subdivision (c) is consistent with Corporations Code Section 7151(c), which provides that the bylaws shall be consistent with the articles of incorporation.

Subdivision (d) is consistent with Section 4350(c), which provides that an operating rule may not be inconsistent with the declaration, articles of incorporation, or bylaws of the association.

Subdivision (e) makes clear that if a provision of a governing document is required by law, that provision controls over an inconsistent provision of another governing document, to the extent that the inconsistency is required in order to comply with the law mandating enactment of the provision.

For example, Section 5105(a)(3) requires that an association adopt an operating rule that permits self-nomination for election to the board. Under subdivision (b), an operating rule adopted in compliance with Section 5105(a)(3) would control over an inconsistent provision of another governing document that prohibits self-nomination.

Subdivision (e) does not apply to an inconsistency that is not strictly required in order to comply with the law. In the example given above, the law only requires that self-nomination be permitted. It says nothing about the procedure to be used for self-nomination. An inconsistency between governing documents on the procedure for self-nomination would not be subject to subdivision (e).

As can be seen, the language in proposed subdivision (e) would only apply to the extent that an *inconsistency* is required in order to comply with a statutory mandate. To the extent that an association can comply with a statutory mandate without creating an inconsistency in its governing documents, the exception stated in subdivision (e) would not apply.

In the example given above, in which the operating rule required that nominations be made at least 30 days before the election, the inconsistency between the timing provisions stated in the declaration and in the operating rule is not *required* in order to comply with the statutory mandate that self-nomination be permitted. Consequently, proposed subdivision (e) would *not* apply to that inconsistency. The timing rule stated in the operating rule would be trumped by the timing rule provided in the declaration.

This would be a very conservative approach. The supremacy of superior documents would only be disturbed to the minimum extent necessary to comply with a statutory mandate.

The staff believes that this new drafting approach might produce more certain results than the language proposed in Memorandum 2010-48.

CONSIDERATION OF MEMBER COMMENTS IN RULEMAKING

Ms. Artus has written to reinforce her suggestion that proposed Section 4360(b) be revised to make clear that member comments on a proposed rule change must be considered at an open board meeting. See First Supplement to Memorandum 2010-47, Exhibit pp. 6-7.

This issue was discussed at pages 31-32 of Memorandum 2010-48. The staff has nothing new to add to that discussion.

RULEMAKING REFERENDUM PROCEDURE

On pages 34-35 of Memorandum 2010-48, the staff recommends a number of revisions of proposed Section 4365, which provides a procedure for member reversal of a recent rule change. Ms. Artus supports the recommended changes but makes a technical suggestion: the word "election" should be used in place of "vote." See First Supplement to Memorandum 2010-47, Exhibit pp. 7-8.

Ms. Artus suggests that "election" might be more consistent with other provisions of the Davis-Stirling Act relating to member elections.

The staff has no objection to making the recommended change, which might improve the clarity of the provision.

Respectfully submitted,

Brian Hebert
Executive Secretary