Study H-855 October 5, 2012

Memorandum 2012-44

Statutory Clarification and Simplification of CID Law (Clean-Up Legislation)

On August 17, 2012, Assembly Bills 805 and 806 (Torres) were enacted, implementing the Commission's recommendation to recodify the Davis-Stirling Common Interest Development Act. See *Statutory Clarification and Simplification of CID Law*, 40 Cal. L. Revision Comm'n Reports 235 (2010). See 2012 Cal. Stat. ch. 180; 2012 Cal. Stat. ch. 181. Both bills have an operative date of January 1, 2014.

Assembly Bill 805 repeals the existing Davis-Stirling Common Interest Development Act (Civ. Code §§ 1350-1378, hereafter, "Davis-Stirling Act"), and replaces it with a reorganized and improved new statute. AB 806 updates statutory cross-references to provisions of the existing Davis-Stirling Act that were repealed by AB 805.

This memorandum recommends the introduction of clean-up legislation needed to address minor technical points that arose during the legislative process.

The following material, discussed below, is attached as an Exhibit:

INADVERTENT OMISSION OF TEXT FROM AB 805

When AB 805 was introduced, some of the language recommended by the Commission was inadvertently omitted from two code sections. The staff regrets not having discovered and corrected those omissions at that time.

The staff now recommends that the omitted language be included in clean-up legislation, as follows:

Civ. Code § 4005 (amended). Effect of headings

4005. Division, part, title, chapter, ~~and~~ article, and section headings do not in any manner affect the scope, meaning, or intent of this act.

Comment. Section 4005 is amended to correct a drafting error.

Civ. Code § 4035 (amended). Delivered to an association

4035. (a) If a provision of this act requires that a document be delivered to an association, the document shall be delivered to the person designated in the annual policy statement, prepared pursuant to Section 5310, to receive documents on behalf of the association. If no person has been designated to receive documents, the document shall be delivered to the president or secretary of the association.

(b) A document delivered pursuant to this section may be delivered by any of the following methods:

(1) First-class mail, postage prepaid, registered or certified mail, express mail, or overnight delivery by an express service carrier.

~~(1)~~ (2) By e-mail, facsimile, or other electronic means, if the association has assented to that method of delivery.

~~(2)~~ (3) By personal delivery, if the association has assented to that method of delivery. If the association accepts a document by personal delivery it shall provide a written receipt acknowledging delivery of the document.

Comment. Section 4035 is amended to correct a drafting error.

SUPERSEDED CONFORMING REVISIONS

Because AB 805 reorganized and renumbered the entirety of the Davis-Stirling Act, it was necessary to correct all statutory cross-references to the former provisions. AB 806 was introduced to make those corrections.

Because the changes in AB 806 were so numerous and purely technical, the bill included a "subordination clause," providing that any conflict between AB 806 and another bill would be resolved in favor of the other bill. (In other words, if both AB 806 and another bill would amend or repeal the same code section, the other bill would affect the section and AB 806 would not.) That is a common approach to managing conflicts with a very large and technical bill.

Two of the sections that would have been amended by AB 806 were also amended by other bills in 2012. See 2012 Cal. Stat. ch. 255 (amending Civ. Code § 2924b); 2012 Cal. Stat. ch. 494 (amending Gov't Code § 12191). Consequently, the cross-reference corrections in those two sections recommended by the Commission did not take effect, and the two sections still contain cross-

references to sections that will be renumbered when AB 805 takes effect on January 1, 2014.

The staff therefore recommends that **the superseded cross-reference corrections be included in clean-up legislation, as follows:**

Civ. Code § 2924b (amended). Request for copy of notice of default or sale

2924b. (a) ….

(f)(1) Notwithstanding subdivision (a), with respect to separate interests governed by an association, as defined in ~~subdivision (a) of~~ Section ~~1351~~ 4080, the association may cause to be filed in the office of the recorder in the county in which the separate interests are situated a request that a mortgagee, trustee, or other person authorized to record a notice of default regarding any of those separate interests mail to the association a copy of any trustee's deed upon sale concerning a separate interest. ….

….

Comment. Subdivision (f) of Section 2924b is amended to correct a cross-reference to former Section 1351(a).

Gov't Code § 12191 (amended). Miscellaneous business entity filing fees

12191. The miscellaneous business entity filing fees are the following:

….

(c) Community Associations and Common Interest Developments:

(1) Filing a statement by a community association in accordance with Section ~~1363.6~~ 5405 of the Civil Code to register the common interest development that it manages: An amount not to exceed thirty dollars ($30).

(2) Filing an amended statement by a community association in accordance with Section ~~1363.6~~ 5405 of the Civil Code: No fee.

Comment. Subdivision (c) of Section 12191 is amended to correct cross-references to former Civil Code Section 1363.6.

OTHER CID BILLS ENACTED IN 2012

When two bills would both amend or repeal the same code section, the bill that is signed by the Governor last (and is therefore given the higher "chapter" number by the Secretary of State) prevails. The change made by the second bill operates and the first bill's change does not. This is colloquially known as "chaptering out" (i.e., the second bill chapters out the first). See Gov't Code

§ 9605. Chaptering out can be avoided through careful and timely drafting in one or more of the conflicting bills.

In 2012, two bills amending the Davis-Stirling Act were introduced and enacted. See AB 1838 (Calderon) (2012 Cal. Stat. ch. 475); AB 2697 (Assembly Committee on Housing and Community Development) (2012 Cal. Stat. ch. 770). The changes to the existing Davis-Stirling Act in those bills were in conflict with AB 805, which entirely repeals the Davis-Stirling Act.

Due to the timing of the three bills, it was anticipated that AB 805 would be signed first, and so would be partially chaptered out by the other two bills. Specifically, the sections affected by the other two bills would *not* be subject to the general repealer in AB 805. When that repealer becomes operative on January 1, 2014, every provision of the Davis-Stirling Act *except* those affected by AB 1838 and AB 2697 would be repealed. That is, in fact, what happened. (The staff had considered trying to draft around that result, but the timing was such that it was easier to let the conflict occur and then fix it in clean-up legislation in 2013.)

In addition, because at the time AB 805 was enacted it was not yet known whether the other two bills would be enacted, the reorganized Davis-Stirling Act does not include the changes made by those two bills.

Two steps are required in order to address the problems that now exist:

(1) The sections affected by AB 1838 and AB 2697 need to be specifically repealed. As noted above, they will not be repealed by the operation of the general repealer in AB 805. **The staff therefore recommends that the clean-up legislation include language to repeal Civil Code Sections 1363.05, 1368, and 1368.2.**

(2) The newly reorganized provisions of the Davis-Stirling Act need to be amended to incorporate the substance of the changes made by AB 1838 and 2697.

Those two steps will fully integrate the effect of AB 1838 and 2697 into the newly enacted Davis-Stirling Act.

In order to implement the second point, **the staff recommends that the following amendments be made:**

Civ. Code § 4090 (amended). "Board meeting"

4090. "Board meeting" means either of the following:

(a) A 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 that is within the authority of the board.

(b) A teleconference, where a sufficient number of directors to establish a quorum of the board, in different locations, are connected by electronic means, through audio or video, or both. A teleconference meeting shall be conducted in a manner that protects the rights of members of the association and otherwise complies with the requirements of this act. Except for a meeting that will be held solely in executive session, the notice of the teleconference meeting shall identify at least one physical location so that members of the association may attend, and at least one director or a person designated by the board shall be present at that location. Participation by directors in a teleconference meeting constitutes presence at that meeting as long as all directors participating are able to hear one another, as well as members of the association speaking on matters before the board.

Comment. Subdivision (b) of Section 4090 is amended to continue, without substantive change, a revision to former Section 1363.05(k)(2) made in 2012 by AB 2697 (Assembly Committee on Housing and Community Development). See 2012 Cal. Stat. ch. 770, § 3. This is a technical revision.

Civ. Code § 4525 (amended). Disclosure to prospective purchaser

4525. (a) The owner of a separate interest shall provide the following documents to a prospective purchaser of the separate interest, as soon as practicable before the transfer of title or the execution of a real property sales contract, as defined in Section 2985:

…

(9) If there is a provision in the governing documents that prohibits the rental or leasing of any of the separate interests in the common interest development to a renter, lessee, or tenant, a statement describing the prohibition ~~and its applicability~~.

…

Comment. Paragraph (9) of subdivision (a) of Section 4525 is amended to continue, without substantive change, a revision to former Section 1368 made in 2012 by AB 2697 (Assembly Committee on Housing and Community Development). See 2012 Cal. Stat. ch. 770, § 4.5. This is a technical revision.

Civ. Code § 4528 (amended). Document disclosure summary form

4528. The form for billing disclosures required by Section 4530 shall be in substantially the following form and in at least 10-point type:

….

Comment. Section 4528 is amended to continue, without substantive change, a revision to former Section 1368.2 made in 2012 by AB 1838 (Calderon). See 2012 Cal. Stat. ch. 475, § 2. This is a technical revision.

Civ. Code § 4530 (amended). Information to be provided by association

4530. (a) Upon written request, the association shall, within 10 days of the mailing or delivery of the request, provide the owner of a separate interest, or any other recipient authorized by the owner, with a copy of the requested documents specified in Section 4525.

(b)(1) Upon receipt of a written request, the association shall provide, on the form described in Section 4528, a written or electronic estimate of the fees that will be assessed for providing the requested documents. The documents required to be made available pursuant to this section may be maintained in electronic form, and may be posted on the association's Internet Web site. Requesting parties shall have the option of receiving the documents by electronic transmission if the association maintains the documents in electronic form. The association may collect a reasonable fee based upon the association's actual cost for the procurement, preparation, reproduction, and delivery of the documents requested pursuant to the provisions of this section.

(2) No additional fees may be charged by the association for the electronic delivery of the documents requested.

(3) (A) A cancellation fee for documents specified in subdivision (a) shall not be collected if either of the following applies:

(i) The request was canceled in writing by the same party that placed the order and work had not yet been performed on the order.

(ii) The request was canceled in writing and any work that had been performed on the order was compensated.

(B) The association shall refund all fees collected pursuant to paragraph (1) if the request was canceled in writing and work had not yet been performed on the order.

(C) If the request was canceled in writing, the association shall refund the share of fees collected pursuant to paragraph (1) that represents the portion of the work not performed on the order.

~~(3)~~ (4) Fees for any documents required by this section shall be distinguished from other fees, fines, or assessments billed as part of the transfer or sales transaction. Delivery of the documents required by this section shall not be withheld for any reason nor subject to any condition except the payment of the fee allowed pursuant to paragraph (1).

~~(4)~~ (5) An association may contract with any person or entity to facilitate compliance with the requirements of this subdivision on behalf of the association.

~~(5)~~ (6) The association shall also provide a recipient authorized by the owner of a separate interest with a copy of the completed form specified in Section 4528 at the time the required documents are delivered.

Comment. Subdivision (b) of Section 4530 is amended to continue, without substantive change, a revision to former Section

1368 made in 2012 by AB 2697 (Assembly Committee on Housing and Community Development). See 2012 Cal. Stat. ch. 770, § 4.5. This is a technical revision.

REVISIONS SUGGESTED BY PUBLIC

The Commission has received two emails proposing specific reforms for inclusion in clean-up legislation. Exhibit pp. 1-3.

In the staff's view, the clean-up legislation should be limited to purely technical revisions that are necessary to correct problems that arose in the process of enacting AB 805 and AB 806. The purpose of those revisions would be to fully effectuate the Commission's recommendation and resolve bill conflicts that arose in 2012.

The staff is reluctant to use the clean-up legislation as a vehicle for new reforms, for two reasons:

(1) The narrow time window that exists to formulate a clean-up proposal for introduction in 2013 (so that it operates when AB 805 and AB 806 operate, on January 1, 2014), does not provide a sufficient opportunity to analyze and publicly vet any new reforms.

(2) A bill that only addresses problems that arose in enacting AB 805 and AB 806, without proposing any new reforms, should be very simple to enact. It will not require a great deal of staff resources and there should be little risk of nonenactment. That would not be true if the bill contains new and untested reform proposals.

For those reasons, the staff recommends against adding the proposed reforms to the clean-up legislation. That recommendation is grounded in procedural concerns. The staff has not evaluated the merits of any of the proposed reforms.

The specific proposals offered by the commenters are summarized briefly below, without any analysis of their merits.

Definition of "Builder" in Section 6000

Duncan McPherson, an attorney with considerable experience on CID matters, suggests a revision to the definition of "builder" that is used in Civil Code Section 6000, a section governing CID construction defect actions. Exhibit p. 1.

Section 6000, which continued Civil Code Section 1375 without substantive change, applies to actions that would be brought against a builder, developer, or general contractor of a CID. Section 6000(a). The section defines "builder" to mean a CID's "declarant." See Section 6000(p)(2). See also Section 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.").

Mr. McPherson points out that, in common practice, the "builder" may not be the "declarant." He recommends that the term "builder" be used without definition, thereby giving it the generally understood meaning of the term.

Preparation of Financial Statements

The Executive Council of Homeowners (hereafter, "ECHO"), proposes changes to the wording and terminology used in three of the Davis-Stirling Act's financial reporting provisions (Civ. Code §§ 5300, 5305, 5500). See Exhibit pp. 2-3. ECHO also proposes adding a new restriction on a CID's ability to increase its regular assessments — it could not do so unless it has complied with the financial review process required by Section 5305. *Id*.

Repair of Exclusive Use Common Area in a CID

ECHO also suggests changes to Civil Code Section 4775(a), which continues Section 1364(a) without substantive change. See Exhibit p. 3. Section 4775(a) reads as follows:

> (a) Unless otherwise provided in the declaration of a common interest development, the association is responsible for repairing, replacing, or maintaining the common area, other than exclusive use common area, and the owner of each separate interest is responsible for maintaining that separate interest and any exclusive use common area appurtenant to the separate interest.

As can be seen, the first clause of that provision provides that an association is responsible for "*repairing, replacing, or maintaining*" the common area (excluding "exclusive use common area"). By contrast, the second clause only addresses an owner's responsibility for "*maintenance*" of exclusive use common

area. The provision is silent on who bears responsibility for "repairing" and "replacing" exclusive use common area.

ECHO explains that the gap in the provision's coverage has caused problems and suggests that it be remedied. ECHO's proposal would require the association to "repair and replace" exclusive use common area.

PROCEDURAL IMPLEMENTATION

In light of the short time that remains if clean-up legislation is to be introduced in 2013, **the staff recommends that the Commission modify its normal procedure, skipping the preparation and circulation of a tentative recommendation, and instead go straight to the approval of a final recommendation.** If the Commission agrees, the staff will prepare a draft of a final recommendation for consideration at the Commission's December meeting.

This truncation of the ordinary process should not cause any problems under the circumstances, because the clean-up legislation would be entirely technical and would only effect changes that have already been approved by the Commission or that were approved by the Legislature in 2012. While interested persons are encouraged to contact the staff if they see any potential problems with the changes recommended in this memorandum, they are so straightforward and modest that a full public comment process is probably not needed.

There is precedent for following an abbreviated process when clean-up legislation must be finalized in a short amount of time. For example, in 2009 the Commission approved a final recommendation for clean-up legislation, without having issued a tentative recommendation. See *Revision of No Contest Clause Statute: Conforming Revisions*, 38 Cal. L. Revision Comm'n Reports 203 (2008).

Is the shortened process described above acceptable?

Respectfully submitted,

Steve Cohen
Staff Counsel

EMAIL FROM DUNCAN MCPHERSON
(OCTOBER 1, 2012)

Brian, the chair of one of the regional groups that makes up the CBIA-DRE council brought up a problem in a recent telephone conference with a definition contained in the resolution dispute provisions of the Davis-Stirling Act which someone picked up on a review of AB 805. The Civil Code definition of Builder in Civil Code Section 6000 in AB 805, which is identical to the definition in the present Act, provides that the term "builder" means "declarant" as defined in CC 4130. The pertinent language is set out below:

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.

6000.
(a) Before an association files a complaint for damages against a builder, developer, or general contractor (respondent) of a common interest development based upon a claim for defects in the design or construction of the common interest development, all of the requirements of this section shall be satisfied with respect to the builder, developer, or general contractor…

(p) (2) "Builder" means the declarant, as defined in Section 4130.

The problem is that the builder is most often not the declarant. In larger subdivisions the builders are often merchant builders who are purchasers of lots or entire phases of a master planned development and the declarant has no connection with the construction of homes. Even in smaller developments the home builder while often an affiliate is a different company from the land developer/declarant entity. What is even more confusing is that in master planned communities very often CC&Rs provide that there can be multiple declarants exercising powers over different areas of the development. While the provision was evidently thought by the person who drafted the construction defect dispute resolution language as a method to tie the provision to the existing Davis-Stirling definitions it was a mistake and does not do anything but possibly would allow the actual builder to say that the provision does not apply to it. The term builder is fairly plain on its own in the context of Section 6000. Our group would like to recommend that Subsection (p)(2) be deleted in the clean-up bill.

EMAIL FROM KERRY MAZZONI
(OCTOBER 1, 2012)

Hi Brian,

The ECHO Legislative Committee and the ECHO Board of Directors have requested that I submit, on their behalf, the following suggestions for "clean-up" to AB 805 and AB 806 and the rationale for the proposals. One document includes suggestions provided and prepared by the ECHO Accountants Panel, the other document refers to Section 1364 and was prepared by one of our attorneys. Please let me know if you have any questions and whether or not the suggested amendments are "non-substantive" enough to be included in your "clean-up" discussion.

Thanks for your consideration.

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ECHO Accountant's Panel Recommendations

Proposal #1:

Paragraph one is similar to the current law but updates the language to the proper professional language and terms. The next section is an addition, as is the last one. The third simply inserts the words "or audit" due to the second paragraph. Each section is shown here as paragraphs for ease of discussion. The addition to section 5605 imposes some teeth to the requirement. There currently are no consequences for not getting the annual review done in a timely manner.

5305: Unless the governing documents impose more stringent standards, a review of the financial statements prepared in accordance with United States Generally Accepted Accounting Principles (GAAP) shall be performed in accordance with professional standards by a licensee of the CA Board of Accountancy for any fiscal year in which the gross income of the association exceeds seventy-five thousand dollars ($75,000);

When the gross income of the association exceeds one million dollars ($1,000,000) an audit by a licensee of the CA Board of Accountancy shall be required.

A copy of the review <u>or audit</u> shall be distributed to the members within 120 days after the close of each fiscal year by individual delivery pursuant to section 4040.

5605 (a)…of subsection (b) of Section 5300 <u>and Section 5305</u>…….

Proposal #2:

This restates the section to make it more clear and understandable.

5500: Unless the governing documents impose more stringent standards, the board shall review on a quarterly basis:

(a) All of the association's cash and marketable securities, bank and/or investment account statements and the related reconciliations of those statements to their general ledger control accounts.

(b) The current fiscal year-to-date Balance Sheet and Income Statement. The Income Statement shall compare actual revenue and expense line items to the current year's budget.
~~~~~~~~~

Proposal #3:

This changes the budget requirement to take into consideration any current year's projected net income or loss and cash flow needs (like insurance coming due two months into the year) into effect when preparing the next year's budget. Mostly the budgets are prepared in a vacuum so that current cash needs and cash carryover/deficits are ignored. Consequently some associations are accumulating huge surpluses or deficits and are ignoring what they are going to do to either generate the cash they need or to use the potentially excess cash they have accumulated.

5300(b)(1): A forecasted income statement prepared on the accrual basis including consideration of prior year's excess or deficit and other cash flow issues.

~~~~~~~~~

Civil Code Section 1364(a) provides:

> (a) Unless otherwise provided in the declaration of a common interest development, the association is responsible for repairing, replacing, or maintaining the common areas, other than exclusive use common areas, and the owner of each separate interest is responsible for maintaining that separate interest and any exclusive use common area appurtenant to the separate interest.

This language has existed since at least 1987.

Section 1364(a) is ambiguous. It creates a default scheme for association maintenance, repair and replacement of the unrestricted common area if the declaration is silent. It also specifies a default requirement for the owner to maintain the exclusive use common area if the declaration is silent.

However, Section 1364(a) does not specify a default duty of either the association or the owner to repair or replace the exclusive use common area if the declaration is silent.

This is a practical problem because many declarations fail to specify responsibility for repair and replacement of exclusive use common area components such as balconies, decks, fences, patios, porches and parking facilities. The board is challenged whether to include these in the reserve study, or whether to enforce a possible obligation of the owner to repair.

It is true that the issue can be resolved by amending the declaration, but often this is difficult due to controversy over the responsibility for the expense or due to apathy in the voting process.

We suggest that the language be amended as follows and provide a grandfathering clause so that the provision only applies to new owners (language for grandfathering not included):

Unless otherwise provided in the declaration of a common interest development, the association is responsible for maintaining the unrestricted common area and for repairing and replacing both the exclusive use and unrestricted common areas, and the owner of each separate interest is responsible for maintaining that separate interest and for maintaining the exclusive use common area appurtenant to the separate interest.

The language is unchanged in the new corresponding Section 4775(a), below.

§ 4775. Maintenance responsibility generally

4775. (a) Unless otherwise provided in the declaration of a common interest development, the association is responsible for repairing, replacing, or maintaining the common area, other than exclusive use common area, and the owner of each separate interest is responsible for maintaining that separate interest and any exclusive use common area appurtenant to the separate interest.
~~~~~~~~~