BACKGROUND PAPER FOR HEARING
November 17, 2005

PROPOSAL FOR CREATING THE OFFICE OF OMBUDSMAN FOR COMMON INTEREST DEVELOPMENTS

JOINT COMMITTEE ON BOARDS, COMMISSIONS, AND CONSUMER PROTECTION
Senator Liz Figueroa, Chair

SUBJECT: SHOULD CALIFORNIA CREATE AN OMBUDSMAN'S OFFICE FOR COMMON INTEREST DEVELOPMENTS?

SUMMARY: This hearing will consider the issues and facts regarding the need for the establishment of an Ombudsman to deal with certain problems faced by those living in and serving on boards of directors of Common Interest Developments.

Existing state law:

1. Enacts the Davis-Stirling Common Interest Development Act which sets forth the rules and regulations under which Home Owner Associations (HOAs) may operate in a common interest development (CID).

2. Provides that parties to most disputes within a CID should first resort to informal processes of dispute resolution, and establishes minimum guidelines to assure such processes in matters that are headed to litigation are "fair, reasonable and expeditious." If the dispute does not involve pending litigation, the parties are not required to use a third party to help resolve their dispute, but must, at a minimum, meet and confer with one another. If either an HOA or a homeowner wishes to file an enforcement action in court, they must first have tried to engage in some form of alternative dispute resolution with a third party – though the law does not require such efforts to be successful, or even to actually occur.

3. Requires a CID to register every two years with the Secretary of State and to provide certain information regarding the association. If the CID fails to register, the CID's rights as a corporation may be suspended and the CID will be subject to monetary penalties.

4. Prohibits the board of directors of a CID from imposing a regular assessment fee that is more than 20% greater than the regular assessment fee for the CID's preceding year; emergency assessments, as defined, are excluded from this limitation.

Recent Legislation:

1. **SB 61 (Battin, Chapter 405, Statutes of 2005)** requires secret ballots and other procedural safeguards for elections in CIDs.

2. **SB 137 (Ducheny, Chapter 452, Statutes of 2005)** protects owners equity in their homes when they fail to pay relatively small assessments to their common interest development associations. HOAs may not file a foreclosure action to collect delinquent assessments of less than $1,800 or any assessments that are more than 12 months delinquent. In such cases, an association may recover the debt by going to small claims court. Also requires, to the extent existing funds are available, that the Department of Consumer Affairs and the Department of Real Estate to develop an education website for the boards of directors of HOAs regarding the role, duties, laws, and responsibilities of board members and the nonjudicial foreclosure process.

3. **AB 1098 (Jones, Chapter 458, Statutes of 2005)** enhances the ability of homeowners to access financial records and board minutes, regulates the way in which boards of directors may grant exclusive use access to common areas.

BACKGROUND

What are CIDs?

Common Interest Developments (CIDs) consist of groups of homeowners who also jointly own a common interest in parts of the property. CIDs include condominiums, community apartment projects, housing cooperatives and planned unit developments. They are characterized by a separate ownership of individual dwelling space coupled with an undivided interest in property common to all owners. An “undivided interest” means that no owner has a “share” of the common property, but rather all own it together without there being any individual portions or areas. Unlike their ownership of their own dwelling space, no owner can individually decide to do anything they want with the common property. The common property may be hallways and lobby areas (in condominiums, for example), swimming pools, parkways, streets, or virtually anything else.

How many CIDs are there?

Both the California Law Revision Commission (CLRC) and the Public Policy Institute of California (PPIC) have studied the emerging issues related to CIDs in California. There is little doubt that CIDs are now an established – and growing – part of California’s social fabric. According to PPIC, there are over 36,000 CIDs in the state that range in size from three to 27,000 units. CIDs make up over 3 million total housing units in California alone, and they represent approximately one quarter of the state's housing stock.

More significantly, PPIC points out that in the 1990s, over 60% of all new residential construction starts in the state were CIDs. This very strongly suggests that any problems currently existing with CIDs will grow at a high rate in the years to come.

What are CCRs?

All owners in a CID must agree to abide by a set of Covenants, Conditions and Restrictions (CCRs) that limit not only the use of the common area, but even certain aspects of the separate ownership interests of each individual. For example, CCRs may regulate the color that homes may be painted, whether owners may have pets, or what kind of trees may be planted on a homeowner's individual property. The California Supreme Court has clearly ruled that the CCRs are presumed to be reasonable and are thus enforceable in virtually all but the most exceptional cases. Consequently, the terms of the CCRs are extremely important for every homeowner to read and understand.

What is an HOA?

The common management of CIDs is the responsibility of a Home Owners Association (HOA), run by an elected board of directors who must be owners in the CID. Among their powers is the ability to enforce and interpret the terms of the CCRs, to levy assessments on the owners, and to create new rules on behalf of the homeowners. In this sense, then, HOAs exercise a form of governmental authority within a CID – and are, in effect, all three branches of the "government:" executive, legislative and judicial.

All those who buy into a CID are required to receive a brief overview of CID ownership. The following statutorily mandated language from that disclosure sums up the rights and responsibilities of CID ownership:

> When contemplating the purchase of a dwelling in a common interest development, you should consider factors beyond the attractiveness of the dwelling units themselves. Study the governing instruments and give careful thought to whether you will be able to exist happily in an atmosphere of cooperative living where the interests of the group must be taken into account as well as the interests of the individual. Remember that managing a common interest development is very much like governing a small community . . . the management can serve you well, but you will have to work for its success.

What is the State's involvement with CIDs?

Except when CIDs are first developed, no state agency provides ongoing oversight to these communities. During initial construction, when the first owners are moving in, the Department of Real Estate oversees the beginning stages of the HOA, particularly focusing on the governing documents, such as the CCRs. When the final homeowners have moved in, DRE involvement ends, and the HOA is fully in charge of all governance.

What do other states do about CIDs?

Other states, including Florida, Nevada and Hawaii, provide services to CID associations similar to the ones being proposed for California. Therefore, their experience can be helpful as California decides how to proceed.

Both Florida and Nevada assess an annual fee paid on homeowners and have found significant public demand for the services of programs regulating CIDs. In 1997, the Nevada Legislature created the Office of the Ombudsman for Owners in Common Interest Communities to provide services to CIDs, including education and informal dispute resolution.

Nevada has approximately 2,073 CIDs made up of 310,501 separate interests, which represents one-tenth the number of CIDs in California. The Nevada Ombudsman charges a $3 annual fee per separate interest and employs 13 full-time staff. In 2003, the Nevada program was expanded to include the power to enforce the laws.

In Hawaii, the Real Estate Commission provides services to condominiums, including referrals and subsidies for mediation services, publishes information on its website and in print, and responds to specific inquires. The Hawaii program is funded by a $4 per unit biennial fee charged to registered condominiums. Hawaii has 135,000 condominiums and in 2004 received 22,000 requests for information or advice. If the experience of Hawaii is extrapolated to California, the Ombudsman could expect to receive 488,000 requests for assistance.

What does the current proposal do?

The proposal now being made is embodied in two bills – AB 770 (Mullin) and SB 551 (Lowenthal). Each bill:

1. Establishes the Office within the Department of Consumer Affairs (DCA), under the supervision and control of the Director of DCA (Director).

2. Provides that the Director shall employ a Common Interest Development Ombudsman (Ombudsman) and other officers and employees necessary to carry out the powers delegated to the Ombudsman by the Director.

3. Requires an association, upon its biennial filing of identifying information with the Secretary of State (SOS), to pay a Common Interest Development Ombudsman fee. The initial fee shall be equal to $10 each two years multiplied by the number of separate interests within the association.

4. Provides that the Ombudsman shall increase or decrease the biennial fee amount every 2 years in order to provide only the revenue that it estimates will be necessary for the operation of the Office. The biennial fee shall not exceed $20 per separate interest in an association.

5. Provides that an association is excused from paying the biennial fee for a given separate interest if the association certifies, on a form developed by SOS, that another association

has already paid the biennial fee for the separate interest. The Ombudsman may adopt rules or regulations to determine which association shall be responsible for paying a separate interest's fee if that separate interest is part of more than one association.

6. Provides that the fee shall not be counted towards the existing provision that an association may not increase regular assessment fees by more than 20%, thereby making the fee potentially an additional amount above the 20% cap on fee increases.

7. Creates the Fee Account of the Common Interest Development Ombudsman Fund and requires SOS to transfer fee revenue to this account for the exclusive purpose of funding the Office.

8. Requires the Ombudsman to offer training materials and courses to CID directors, officers and owners regarding the operation of a CID and the rights and duties of an association owner. Provides that a fee may be charged for training materials or courses that do not exceed the actual cost.

9. Requires the Ombudsman to maintain a toll-free telephone number.

10. Requires the Ombudsman to maintain an Internet website with the following information:
    a. Relevant statutes and regulations pertaining to the operation of a CID
    b. Information concerning nonjudical resolution of disputes, including locally available dispute resolution programs
    c. Description of the services offered by the Ombudsman
    d. Contact information for the Ombudsman
    e. Any changes to laws governing CIDs and any other information that the Ombudsman deems to be useful to an association or owner.

11. Requires information provided on the website to also be available in written form. Allows the Ombudsman to charge a fee for these materials not to exceed their actual cost of printing and delivery.

12. Requires an association to provide its members with annual written notice of the website address and toll free number of the Ombudsman.

13. Provides that any interested party may request the Ombudsman to provide assistance in resolving a dispute involving the law governing CIDs or the governing documents of a CID.

14. Requires the Ombudsman, after receiving a complaint, to confer with the interested parties and attempt to resolve the dispute through mutual agreement. Provides that the Ombudsman may offer to mediate a dispute if it cannot first be resolved through informal conference.

15. Provides the Ombudsman may adopt a fee of not more than $25 for mediation services or may contract with private parties to provide mediation services.

16. Requires that within 60 days of assuming office an association director must file a certification with the Ombudsman that they have read each of the following: the declaration, articles of incorporation, by-laws of the association and either the Davis-Stirling Common Interest Development Act or a summary of the law.

17. Requires a person who is providing or proposes to provide the services of a CID manager to disclose to the board of directors in writing, on an annual basis, that they have read the governing document of the association.

18. Requires the Ombudsman to report no later than October 1 annually to the Legislature on the following:
    a. The number of requests for assistance received
    b. How a request was or was not resolved and the staff time required to resolve the inquiry
    c. The most common and serious types of disputes
    d. Any recommendations for statutory reform.

19. Requires the Ombudsman to submit, on or before January 1, 2009, recommendations to the Legislature on the scope of the Office and the following issues:
    a. Whether or not the Ombudsman should be authorized to enforce CID law
    b. Whether or not the Ombudsman should have authority to oversee association elections
    c. Whether or not the provisions requiring a new association director or managing agent to certify they have read the governing documents should be revised.

20. Allows the Ombudsman to establish an advisory committee that is comprised of a fair representation of interests involved in CIDs.

21. Provides that information and advice provided by the Ombudsman has no binding legal effect and is not subject to the rulemaking provisions of the Administrative Procedure Act.

22. Provides that the Ombudsman shall adopt rules and regulations governing the duties of the Office in accordance with the Administrative Procedures Act.

23. Provides that the Office shall sunset on January 1, 2011 unless another statute is enacted to delete or extend that date.

24. Makes legislative findings including the fact that there are 36,000 CIDs in the state, the complexities that volunteer director's face in managing and complying with existing laws, and the adversarial nature of private litigation which is the mechanism under existing law to enforce CID law

QUESTIONS FOR THE JOINT COMMITTEE:

I. Is there a need for an Ombudsman? Does the ability of homeowners in CIDs to vote or run for office adequately protect their interests? Is there sufficient evidence that there is a problem these political and more local remedies can not solve?

A. Are homeowners protected by their right to participate in the political process?

The first question in a Sunrise review is always whether there is a great enough need for a new entity that would warrant government action. With respect to the creation of the Ombudsman's office, the question focuses on whether the current ability of homeowners to vote and run for office adequately protects their interest.

The ordinary presumption that the political openness of a democratic system allowing people to both (1) vote and (2) run for office, by definition protects the interest of everyone. While some people will always be dissatisfied with particular outcomes, the system itself permits both change over time and full participation for anyone who is sufficiently interested. In at least one respect, the CID political process is even less restrictive than the broader political system, since there is not even a registration requirement – by virtue of *being* a homeowner, every owner is qualified to vote in all elections in the CID.

However, there are qualifications to this presumption. The CLRC makes a cogent argument concerning the problems:

> CIDs are governed by volunteer directors, elected from among the unit owners. Faced with the complexity of CID law, many of these volunteers make mistakes and violate procedures for conducting hearings, adopting budgets, establishing reserves, enforcing rules and restrictions, and collecting assessments. Many CID homeowners do not understand their rights under CID law and under their association's governing documents. These sorts of mistakes and misunderstandings inevitably lead to conflicts within the development, either between the association and an individual homeowner, or between homeowners.
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> A homeowner who believes that a community association is violating the law or has otherwise breached its duties has no effective remedy other than civil litigation. Litigation is not an ideal remedy for many common interest development disputes. Homeowners who sue their associations are suing their neighbors and themselves. The adversarial nature of litigation creates animosity that can degrade the quality of life within the community and make future disputes more likely to arise. Litigation imposes costs on the community as a whole – costs that must be paid by all members through increased assessments.

In addition, the California Alliance for Retired Americans (CARA) emphasizes the fact that the HOA exercises virtually all governmental authority – executive, legislative and judicial. They make the rules, enforce the rules and interpret the rules that will affect the lives of virtually every one of the homeowners within the CID. This concentration of power in one, usually volunteer

association can lead to suspicion and distrust among homeowners, as well as abuse by less-scrupulous or well-informed board members, in both small matters and large.

Consequently, it is extremely important that (1) homeowners in CIDs have some understanding of the law governing CIDs, and (2) boards of directors know what it is they are doing, and what the legal limits of their authority are. The only remedy for mistakes, misunderstandings, lack of knowledge, or other problems that result in irreconcilable differences is for owners to file a lawsuit in Superior Court. For a number of reasons, this provides for some serious quandaries.

B. The problem of volunteerism.

The problem of volunteerism is extremely important to understand in this context.

CIDs affect the most critical investment most people ever make – an investment in their home. And, as CARA notes, HOAs have tremendous government-like power over all the owners. As part of the exclusive authority discussed above, they have clear authority to, effectively, tax all CID homeowners, both in the form of regular assessments, as well as special assessments for extraordinary or unanticipated costs. This means HOAs can have budgets of hundreds of thousands or even millions of dollars. Boards have the sole authority to collect those funds, and determine what level of assessment is necessary. They also have the sole authority to spend those funds for the common benefit of all.

In addition, the HOA rulemaking authority is equally important. As noted above, the California Supreme Court has ruled that CCRs are nearly always enforceable against homeowners by a court, even if they appear unreasonable to a particular homeowner – and homeowners who the board decides are not in compliance can find themselves facing a foreclosure on their home. It is extremely hard for a homeowner to challenge the rules under which they live, if they have been approved by the HOA, and the stakes for every individual homeowner can be very high.

It is important to focus on this for a moment. CID boards of directors have the ability to limit a freedom which has no counterpart for nearly any other kind of government authority – the liberty of an individual homeowner to use their own property. Whether it comes to how long a garage door can be open, or the color of one's own house, the rules in a CID are the rules, and if a majority of homeowners has agreed to prohibit particular uses of property for the commonly-shared good, those prohibitions are enforceable. While this power is not unlimited, its existence in this context is fairly unique, and worth paying special attention to.

The consequence of this power is that CID homeowners have a direct and personal interest in being active in the HOA in a way they might not feel exists in other forms of government. While most people who get involved in political activity at the local, state or federal level do so as an individual choice – and many decide not to make that choice – participation in an HOA is a necessity of ownership in CIDs. People who might not otherwise have an inclination to get politically involved in the broader community find that rules and assessments affecting something as important as their home ownership require participation. While this is fully disclosed to everyone buying into a CID, it is clear that a substantial number of CID owners do not fully comprehend how powerful the terms in the CCRs, the HOA and its board of directors can be – and how critical it can be to them to be an active member of the HOA.

The problems are most acute when volunteers on the board of directors are themselves unclear about the extent of their authority, or imprecise in their understanding of procedures that have been statutorily established to protect the rights of all homeowners in the association. In many cases, professional management companies provide assistance and guidance to HOA boards, and this can be invaluable. These companies, however, charge the associations a fee for their services and expertise, which is an additional cost to the homeowners. And, of course, the professionals are not universally relied upon. Many CIDs are relatively small, and decide they cannot afford the expense of a professional management company.

But even in the most professionally managed CID, the managers are simply advisors *to the board.* They do not, themselves, make any decisions. Like a lawyer, the board is the manager's client, and the manager cannot make any decision on its own. The manager provides his or her best professional advice, and then the client – in this case, the board – makes the final decision.

In the natural course of things, even in professionally managed CIDs, disputes often arise among neighbors, as they do in virtually every community. But CID disputes have an extra dimension. They are, by definition, between neighbors – and not just neighbors who live near one another, but neighbors who have a common stake – both social and economic – in common areas and common rules.

As CLRC points out, between the problems of volunteer boards making mistakes, and homeowners who may misunderstand what their rights and obligations are, CIDs present some unique challenges. Everyone takes classes in school on the way that government works, and therefore has a rudimentary knowledge of what it means to be a citizen. While HOA membership is similar, its importance is too often undervalued, when it is realized at all. Few HOA members are conversant with the terms of their CCRs, the most fundamental set of rules in their CID. Fewer still are aware of the Davis-Stirling Act, which governs their daily lives, and will necessarily be invoked whenever any dispute arises, assessment is contemplated, CCR change is adopted, board election occurs, or in any of countless other situations that affect the ongoing operation of a CID.

This is to say that the lack of information about the rules, documents and laws governing CIDs is a source of innumerable problems or disputes that either should not have occurred, or that could have been resolved in a manner set out in law which the inexperienced non-professionals either do not know about or do not fully comprehend.

There is, however, another related problem – board self-interest. Whether a board is exceptionally knowledgeable or entirely inexpert, there may sometimes be a tendency for some or all members to close ranks with one another against various groups of homeowners, or even against an individual who is viewed as a pest. This may happen consciously or unconsciously. The Joint Committee has received credible information about this problem developing in HOAs from widely disparate parts of the state. The problems – all allegations at this point – range from boards who do not follow the law in releasing financial records to homeowners who have made a valid request; to formation of board cabals that freeze out unwanted members and do business at (unlawful) private meetings without the participation of ostracized members; to board members that direct business to one another's private companies. And this is not at all an exhaustive list.

When these kinds of problems develop, the argument about political participation as the proper resolution to disputes is at its weakest, since it is the board that is, in fact, undermining the very concept of political participation. Refusing to release information upon which the board relies to make decisions is one of the most effective ways of preventing homeowners from examining – and challenging – board decisions and the board decision-making process. This is similar to any other kind of corporation refusing to let shareholders see the information the board relies on – or the state government refusing to comply with a proper Public Records Act inquiry. Those who have a direct, financial stake in the future of the corporation have a right to know about the soundness of decisions that are being made about their investment, just as citizens have the right to know how it is that government makes its public policy decisions. That is why corporate disclosure laws and the Public Records Act exist.

Similarly, when HOA boards refuse to obey the laws requiring that they do business in a way that assures that decision-making will be transparent to all members of the HOA, and that decisions will be made by all duly elected board members, they have abandoned even the most rudimentary precepts of the democratic process. Enforcement of and punishment for such transgressions should be among the very highest priority of the laws related to CIDs.

And this raises the next critical issue. Many of these problems are clearly matters that are already against the law. But, for the most part enforcement falls on members of the HOA. Because of the concentration of all power within the CID in the board, this means the next step must necessarily be outside the board, and that virtually necessitates the filing of a lawsuit against the board.

And, again, CLRC has noted the two critical problems with this. First, the cost of private litigation is burdensome on individual homeowners at best, and can often be prohibitive. Second, it involves neighbors suing neighbors, which can then poison the atmosphere within the community for years to come, irrespective of the outcome.

Some of the matters reported to the Joint Committee would come under the jurisdiction of the state Attorney General, and have been referred to that office. But the AG's office is enormous, and oversees thousands of different areas of the law, some of them with far higher profiles than HOA board self-dealing or refusal to obey disclosure laws. While these problems are of enormous importance to individual homeowners, and can have a substantial effect on economic or property rights, they may pale in comparison to the kinds of cases that often demand the attention of the state's Attorney General, or even local law enforcement.

The question of whether the Ombudsman's office should have enforcement power has been raised and put on hold for the present. If the office is established, one of its duties under the current proposal is to make a recommendation about whether enforcement should ultimately fall within its jurisdiction.

C. The problem of resolving disputes within CIDs under current law and under the proposed Ombudsman.

However the enforcement process is resolved, disputes within the CID remain one of the core problems. They can range from the fairly small (parking, pets, noise) to the monumental (reserve depletion, corruption, seven-figure maintenance and repair projects).

Many of the most serious kinds of disputes can be resolved in new requirements for dispute resolution which went into effect as of January 1, 2005. This provision was recommended by CLRC in 2003 to help solve emerging problems related to pending litigation. By definition, disputes that have gotten so bad that litigation is contemplated are ripe for some process that will help fend off that drastic step. This provision will certainly help.

It is, however, limited. CLRC points out that the only provisions of the law explicitly mentioning alternative dispute resolution are merely advisory. The parties are required to attempt ADR, but not to complete it. And, again, this provision applies only to disputes in which someone is contemplating filing a lawsuit.

Many more disputes do not reach this stage. As to them, there is only a requirement that the parties meet and confer with one another. The fact that the law actually requires something as elementary as two parties meeting and conferring may suggest how minor some CID disputes can be.

The law does not require that they come before a neutral third party – either a mediator or an arbitrator – to help them work out their differences and come to some resolution. This is, of course, simple common sense, and should always be encouraged. In fact, some homeowners take advantage of locally provided mediation services, both public and private. The DCA has a mediation program that operates in most counties throughout the state, as do many other kinds of organizations. Because these services are dispersed and dependent on state and local governments or other non-governmental organizations, and because they provide mediation for all manner of disputes, it is not clear how frequently homeowners take advantage of them in the CID context. As with most such services, these can and do involve some cost to the homeowners.

The Ombudsman proposed here would offer an additional option along these lines. The Ombudsman could provide its own mediation services, or could contract with outside mediators.

An additional step forward was taken this year to avoid some disputes in the first place. SB 137 requires the DCA and the DRE to develop a website to provide information to boards of directors, as well as homeowners, about what, exactly, the law requires for CIDs, the procedures that are provided for, and how disputes are to be resolved. There is no telling how many disputes arise because of a lack of information about what, exactly, is or is not permitted under the existing legal framework. But it is not hard to imagine that making this information available in a centralized location, with an authoritative, reader-friendly and up-to-date summary of key provisions will be extremely useful in heading off some disputes. While most professional property managers will be familiar with this information, this website will assure that boards who are not being professionally advised, and, more important, all homeowners, will have easy

access to the rules and procedures that the state has established to govern the internal affairs of CIDs.

However, a central document will not be available on this website – the individual CC&Rs applicable to any particular CID. By definition, these are unique for each CID. Therefore, the informational function of the website will have a clear and unavoidable limit that cannot be addressed by the state.

Joint Committee staff has been informed that initial steps by DCA and DRE to create this website are now being taken.

II. Would residents of CIDs support a fee to fund the Ombudsman? Do those who are most directly affected by CIDs (i.e., those who live in them) see enough need that they would be willing to fund the office with their own money? If so, at what fee level would that support begin to deteriorate?

The second major question is how residents of CIDs would respond to a fee that would fund the Ombudsman's office. According to the Assembly Housing Committee, each dollar of the fee is estimated to raise $2.1 million for the office. Thus, using the operative assumption, a fee of one dollar per CID unit would raise $2.1 million, two dollars would raise $4.2 million, and five dollars per CID unit would result in budget for the Ombudsman of about $10.5 million.

Even at the proposed level of five dollars per unit per year ($10 biennially), this is a nominal amount for the vast majority of homeowners. While the proposal places the burden of paying the assessment on each CID, there is little doubt that the fee would ultimately fall on each homeowner.

However, the question is less about the amount of the fee as the perceived need among homeowners for what it will provide. Do homeowners actually support the idea that an Ombudsman's office is needed?

As noted in the previous section, DCA and DRE are currently developing the informational website now required by law to help centralize practical information about CIDs and HOAs so that both homeowners and boards of directors will be able to have easy and authoritative access to the rules that apply to CIDs. What additional services will the Ombudsman provide?

A. Providing Information

Clearly, an Ombudsman has the potential to be more active in providing information than a passive website would be. However, as is customary with governmental offices, the Ombudsman would have to stop short of providing legal advice, both because of potential liability issues, as well as to avoid problems of separation of powers. Thus, the office would be able to pass along information about *what* the law is, but not *how* ambiguous or unclear law should be interpreted.

The information, of course, will only be as valuable as the number of people who access it. Knowing this kind of data will be critical to determining, after the fact, whether the Ombudsman

is filling the need this bill anticipates. Thus, if the office is established, it should have an obligation to keep track of the number of phone calls it receives, the number and kinds of inquiries it gets, the volume of materials it distributes, and, with respect to its website, the number of visitors to the site, as well as the number of *unique* visitors (in order to separate out repeat visitors) and, most important, what parts of the site are actually being *used*. Similarly, the kinds of customer satisfaction data that DCA boards now collect will also be important. This will permit a more helpful overview of how useful the site is in some important specifics.

B. Mediation and the fee cap

The Ombudsman's mediation function would certainly be valuable in many cases. Mediation, rather than arbitration or lawsuits, is designed so that the parties, themselves, arrive at a solution, rather than having one imposed on them. The mediator helps them arrive at their own resolution. As noted by CLRC, this sort of cooperative approach, rather than the more antagonistic model of litigation (or even arbitration) is particularly appropriate for the kinds of disputes that arise in CIDs.

Many kinds of problems will be able to be solved over the Ombudsman's toll-free telephone line. This will be particularly true of problems that arise simply because of a misunderstanding about what the law permits, forbids or requires. If one or both parties are misinformed about a particular procedure laid out in the law, for example, a phone call to the Ombudsman's office would be able to provide the relevant answer, and quickly resolve the problem.

But there will be other problems that require direct participation of the disputants and a mediator. These will necessarily be much more difficult, and fact-intensive disputes.

The proposal anticipates that the Ombudsman would, itself, conduct some mediations, and that it could contract out for others. The very low fee in the proposal for such mediations – $25.00 – is well below what the actual cost of such mediations would be in the private sector. This may prove to be an issue.

There could be three potential approaches to the question of what, exactly, the fee will be for. First, the Ombudsman could be established to subsidize the cost of mediation. This could be viewed as a valuable service by homeowners, but it would clearly be the most expensive of the options. If the Ombudsman is intended to subsidize the cost of mediation, this should be an explicit part of the bill. The current $25.00 cap on this service can be read in this way. Under that reading, the $25.00 is a cap *on what homeowners are expected to pay for mediation services*. Any cost above the $25.00 would have to be borne either by the Ombudsman, or foregone by any mediators it contracts with.

At the other extreme, the proposal could be seen as simply facilitating mediation between and among homeowners. This would be, potentially, the least costly of the options to the Ombudsman. Under this reading, the $25.00 fee is what the homeowner would be expected to pay *to the Ombudsman's office*, but that any other costs would be borne by the homeowner and/or board. While this would be the least costly of the options from the perspective of the Ombudsman's office, it could actually be the most costly to homeowners, since they would have to pay both the cost of the mediation *and* the fee to the Ombudsman for the service of facilitation. While it may be difficult for homeowners to seek out mediators, homeowners would

certainly have to determine whether paying a fee to the Ombudsman (which could certainly be less than the $25.00 cap) is of adequate value to have this information centralized.

In the middle is a more pragmatic reading, which is that the Ombudsman would provide mediation for those least able to pay, and the fee would be used to fund those services, but that homeowners of adequate income would be expected to pay for their own mediation services. This reading is the least consistent with the current language.

In addition, it is important to note that because of the nature of mediation services, the Ombudsman would nearly have to have a number of regional offices, or have contracts with offices throughout the state. Mediation is not best accomplished over the phone, and would seem to require physical presence. This fact would have to be taken into account in estimating the costs of an Ombudsman. Locations in ten, or even six regions in a state as large as California, where CIDs are widespread, would involve office rental costs that might eat up a large portion of any proposed budget – and would still frequently involve someone traveling for hours, whether it is Ombudsman staff or homeowners and board members. And these costs are in addition to the actual costs of mediation, itself.

This implicates the budget for the office, and will require close attention during the Appropriations process. Official data from other states about how their mediation programs work and what budgets they are able to work under would be extremely important.

C. Information gathering

Another important and less costly part of the proposal would be as a central repository for gathering and analyzing data about CIDs in California. The Secretary of State's office has only limited registration information at present, and the studies that have so far been done of CIDs – by CLRC and PPIC – have had to rely on incomplete information and extrapolations.

Again, however, the central question here is whether the CID homeowner who would have to pay for this informational function of the Ombudsman would view those services as sufficiently valuable to them that they would be willing to pay for them. The lack of information on CIDs is fairly clear, but the question is whether gathering it is a cost CID homeowners would see adequate value in.

If the homeowners are willing to pay for an Ombudsman, how much would they be willing to pay? There has been no formal (or informal) survey of homeowners in California, so there is no hard data on this point. Once again, the experience of other states is the only available guide. Florida charges four dollars per unit, and Nevada about three dollars – though this could go up to four dollars to reflect the actual expenses in that state for the Ombudsman.

III. **If there is support for this proposal, where should it be located? Does the Administration that would have to operate the office support the proposal? Where in state government should the Ombudsman be located?**

If there is a need for an Ombudsman, the next question will be where it should be located. There are two logical places – the Department of Consumer Affairs (DCA), or the Department of Real

Estate (DRE).

A. Placement in DCA

According to the sponsor, DCA was chosen to house the Ombudsman primarily because of DCA's overall mission: to protect the public by receiving, investigating and resolving complaints and because of its experience in dispute resolution. DCA serves as an umbrella organization overseeing a number of semi-autonomous regulatory bodies, and is generally known among consumers. DCA has had experience in regulating various businesses and professions on behalf of both licensees and consumers, themselves. This experience would prove valuable in starting up a new entity like the Ombudsman.

In addition, one of the key functions of the Ombudsman – mediation – is already part of the DCA's portfolio. At the very least, this function of the Ombudsman would seem to fit well with the DCA mediation program. However, in light of the potentially very large number of mediation cases that this bill could require, it will be critical to sort out what kinds of cooperation, interaction or consolidation would be required if the Ombudsman were located in DCA.

B. Placement in DRE

Both the Executive Council of Homeowners (ECHO) and the California Alliance for Consumer Protection have requested the author consider placing the Ombudsman in the Department of Real Estate (DRE) as an alternative to DCA. DRE already supervises the development of a CID's original budget and governing documents, and thus is the only state entity with experience in CIDs. In contrast, DCA has no existing authority over CIDs at all.

ECHO also suggests that the Ombudsman may one day lead to an additional, and vital, state role in evaluating and monitoring the financial health of community associations and in setting standards for preserving member equity in community reserves. ECHO asserts that DRE would be better equipped to deal with this expanded role than DCA.