Study H-855 July 12, 2005

First Supplement to Memorandum 2005-25

Statutory Clarification and Simplification of CID Law (Public Comment)

We received two letters commenting on Memorandum 2005-25 (available at www.clrc.ca.gov). Those letters are included in the Exhibit as follows, and are discussed below:

Exhibit p.

1. Mel Klein (July 2-3, 2005) 1
2. George K. Staropoli, Scottsdale AZ (July 6, 2005) 6

PRIORITIES

Mr. Klein is disappointed that the Commission is proceeding with the statutory reorganization project before tackling more substantive problems. See Exhibit p. 1. In particular, he sees a pressing need for reform of CID election law, in order to ensure voter confidentiality. See Exhibit pp. 2, 4-5. Note that there are currently two bills pending before the Legislature that would significantly reform CID election rules. See AB 1098 (Jones), SB 61 (Battin).

Mr. Klein also discusses problems relating to enforcement of CID law. He suggests that the existing authority of a city attorney to file an unfair business practice lawsuit (under Business and Professsions Code Section 17200) provides an underutilized remedy for CID homeowners. He suggests that the proposed law should emphasize that remedy. See Exhibit pp. 3-4.

The issues raised by Mr. Klein are beyond the scope of the material presented in Memorandum 2005-25. However, the staff will keep Mr. Klein's suggestions in mind when working on the material relating to elections and enforcement.

HOMEOWNER ASSOCIATION AS LOCAL GOVERNMENT

Mr. Staropoli asserts that a homeowner association has much more in common with a local government entity than it does with the typical nonprofit corporation. See Exhibit p. 6. Accordingly, he feels that a homeowner association should be subject to the same constitutional and statutory constraints that govern a state entity:

> Our system of government with its checks and balances, separation of powers, "clean elections" procedures, due process protections in terms of sufficient notice of violations and hearings in which the homeowner can confront the allegations, examine the witnesses, and present evidence must be applied to CIDs.

Id.

Mr. Staropoli points to three provisions in the proposed law and objects that they are not consistent with his views. See Exhibit pp. 6 (proposed Section 4080, definition of "association"), 7 (proposed Section 4095(b), definition of "common interest development"), 8 (proposed Section 6175(a), liberal construction of governing documents). However, in each of those provisions the proposed law merely continues existing law.

The issue raised by Mr. Staropoli — the extent to which a CID should be subject to the sorts of constraints that apply to a governmental entity — is an important one. However, it is beyond the scope of the current project. The Commission will consider the issue in a later stage of its general study of CID law.

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary

RE Memorandum 2005-25

Saturday, July 02, 2005

I must say I am in almost total agreement with the objections raised by Mr Bruce Osterberg.

As summarized in the CLRC memorandum: "Mr. Osterberg, a CID homeowner, is skeptical about the merits of proceeding with this project while significant substantive problems go unaddressed."

You respond with the observation that: "The Commission has recommended the creation of a state CID Ombudsperson to assist with such problems."

I am afraid that the creation of an Ombudsman will do very, very, little to assist with such problems.

An Ombudsman can be helpful when there are honest disputes between parties, even when one of the parties might be completely unreasonable and obstinate. An Ombudsman is of no use whatsoever when one of the parties simply refuses to comply with the law, when one of the parties might have corrupt intent.

Another of the benefits of an Ombudsman cited in earlier memoranda is that he would compile reports noting and assessing problematic issues in CIDs.

How many reports do we need? The problems are not unknown, certainly not the more serious ones. Homeowners have been crying out for relief from such problems for years.

To say that the creation of an Ombudsman assists with problems of enforcement mentioned by Mr Osterberg is hardly a fair representation. I feel, and I suspect many others feel, that the creation of an Ombudsman without enforcement powers does exactly the opposite: it puts *off* dealing with the serious problems of CIDs for a substantial period of years.

I do differ with the comments of Mr Osterberg, however, in two regards.

First, while it is very disappointing to be going forward with the current project before dealing with the more fundamental issues, we shouldn't disdain dealing with these other, important, matters while we wait for new momentum. After all, the CLRC doesn't decide all by themselves what gets done and what doesn't get done. There is a legislature to contend with, and apparently some legislators are not keyed to accept recommendations for enforcement just now (even those *already* offered by the CLRC).

So, insofar as the work of the CLRC is concerned, there is little more to be done at this time. We can only write to our legislators as individuals (as I indeed have.)
My other, more serious, "difference" with Mr Osterberg is that I do not feel that the answer to our problems lies in enforcement, by which I mean that enforcement, too, will not suffice. The underlying law is itself fundamentally inappropriate in one crucial respect, and no amount of enforcement will correct the problem. (This consideration also speaks to the current effort of rewriting Davis Stirling.)

The law I refer to here as being inappropriate is the law for Board elections in Community Interest Developments.

It is absolutely essential to recognize that the relationship between Board and shareholders in a CID is *completely* different than what it is in the case of other corporate entities. A shareholder in General Motors might not care a whit whether the Board knows or doesn't know who the shareholder supported in a Board election; the Board of General Motors can't turn off your hot water.

Accordingly, a most basic, vital, indispensable element of CID election law *must* be an inviolate assurance of confidentiality of the shareholder ballot in Board elections. The law for corporate elections does not provide such assurance. For example:

- Following an election the Board has full control of the ballots, and a Board can, and surely some do, review the ballots to see how individual shareholders voted.
- Prior to an election, the Board can "demand" proxies from shareholders, and single out as opposition those who refuse to tender their proxies.

What is really needed, as a first step, is that a revised election law for the CID be thought out by the CLRC, one that provides complete assurance of confidentiality, this new law then to be incorporated in a rewritten Davis-Stirling code.

RE Memorandum 2005-25

Sunday, July 03, 2005

In the face of the disappointing response in the legislature to the proposal of the CLRC that would have created an agency with the minimal powers necessary to address violations of law in CIDs, I would like here to consider where matters stand, and see how we can salvage a decent outcome with what we have available.

Enforcement: I believe this may yet turn out to be the least of our problems, in fact hardly a problem at all.

While many of us have insisted on an agency with enforcement powers, there were others, on both sides, who questioned the idea. Those who feel enforcement is currently lacking, were nevertheless worried that lobbying groups would corrupt the new government agency. Those on the other side expressed concerns with establishing yet another government agency, particularly one with enforcement authority.

What we have left over from CLRC deliberations, however, is that enforcement authority is *already* provided for, in the offices of City Attorneys; I refer you to the comments of the Special Assistant Attorney General for Consumer Policy, Coordination and Development, as reported in MM05-10s(1):

> B. The Attorney General and district attorneys and some city attorneys can file actions under Business and Professions Code §17200 against anyone engaged in any business who violates any law, *including laws relating to non-profit companies and laws relating to CIDs* (emphasis added).

I believe that this option will become much better recognized, and more readily available, as Davis-Stirling is rewritten, and this authority, now coded under Business and Professions, is written explicitly into Davis-Stirling.

Furthermore, I would strongly urge that funds that are to be collected for the new agency under the legislation proposed by the CLRC, that those funds be shared with the City Attorneys, given that City Attorneys will be handling some responsibilities that were originally intended for the new agency.

Finally, I believe that a suitable fee should be charged a party bringing a complaint to a City Attorney, and that the violator of law be required to refund the fee should the City Attorney find the complaint to be valid and an enforcement action undertaken.

This last proposal would have several benefits: It would give pause to the potential complainant, which in turn would reduce demands on resources of the City Attorney, and the fee would also serve to compensate the City Attorney in some small degree. Even more significantly, providing for a fee would create a kind of formality in the process, and this would make it far more unlikely that complaints would be treated dismissively.

Note: After reading in CLRC report number MM05-10s(1) that a City Attorney has authority to enforce CID law, we successfully engaged our (reluctant) City Attorney to investigate complaints of lawless Board conduct in our Association, so this is more than just a theoretical possibility. It works, and it works now, without any further legislation. Best of all, it works as it should. It is entirely appropriate that the City Attorney investigate and take enforcement action against violations of Civil Codes in CIDs.

Ombudsman: With responsibility for enforcement of Civil Codes in the hands of City Attorneys, the CLRC legislation is just fine as it now stands, filling a complementary role, but a useful one. An Ombudsman would help in educating the communities in the law; he or she would help the parties resolve disputes arising from the governing documents; the Ombudsman would refer complainants to the City Attorney when there is a perceived violation of law.

While there would still be no means of dealing with violations of the governing documents in the absence of cooperation by the parties, the data collection function of the Ombudsman could identify problem areas, which could then be dealt with in Davis-Stirling legislation, and thereafter these would be matters of law, subject to enforcement by City Attorneys.

Elections: Finally, and paramount, there is the question of elections. We need not wait for data from the Ombudsman to identify this one as a problem area; we already have far more than enough evidence to identify the election process as one of the most, if not *the* most, problematic area of all.

There are three essentials in any election process: fairness (in nomination procedures, campaigning, decisions of the Inspector of Elections), integrity (validity of proxies, accuracy of the count) and confidentiality of the vote.

As far as I can tell, there is no possible way to achieve these objectives without completely removing from Boards and Management all authority in matters related to elections. This is contrary to current Corporate law, and it one thing that must be changed in the law

when Davis-Stirling is rewritten for CIDs, if we are to have responsible, self-governing, entities.

I am aware that there are those among us who believe that it is important that the presiding Board retain authority and control over all Corporate matters, and I am all with that, but not to the extent that it could mean putting persons who were not elected on the Board, because an election was conducted improperly. That would be paradoxically self-defeating. By insisting on complete Board authority, the complete authority of the Board could well be given over to persons who should not be on the Board at all!

I believe your earlier correspondent is entirely correct in identifying feelings of helplessness among shareholders as a primary reason for the frequent breakdowns in governance of CIDs.

Please; give us rule of law, give us fair elections, and we can manage our own affairs.

Citizens for Constitutional Local Government, Inc
5419 E. Piping Rock Road, Scottsdale, AZ 85254-2952
602-228-2891 / 602-996-3007
info@pvtgov.org http://pvtgov.org

July 6, 2005

Brian Hebert
Assistant Executive Secretary
California Law Review Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

SENT BY EMAIL

RE: CLRC Memorandum 2005-25, Draft of Civil Code §§ 4000 et seq.

Dear Mr. Hebert:

Previously, in my March 14, 2005 email letter to CLRC relating to CLRC memorandum 2005-3, the Homeowners Bill of Rights, I voiced my concerns for the continued focus on CIDs as a property interest issue and the lack of protections of homeowners with respect to de facto municipal governance by these CIDs. I feel I must repeat my concerns with respect to the proposed draft of the Common Interest Development legislation.

I will address my concerns just to two sections in the proposed Civil Code. First, the definition of "Association", § 4048, is a simple statement that speaks only of managing rather than of governing the subdivision as if its functions, duties and responsibilities are simple those of any other nonprofit corporation. I ask, "What other nonprofit organization mandates membership in a specific territory, with compulsory assessments – taxes, since the CID does not provide a service or produce akin to a business -- subjecting the organization's members to statutory requirements relating to the loss of the member's private property, their homes, and to other penalties and fines affecting their property -- CID police powers -- also enforced by statute?" A reasonable person would have to agree that such conditions and restrictions define a civil government more so than an everyday nonprofit organization.

Our system of government with its checks and balances, separation of powers, "clean elections" procedures, due process protections in terms of sufficient notice of violations and hearings in which the homeowner can confront the allegations, examine the witnesses, and present evidence must be applied to CIDs. The corporate form of governance is not democratic, nor was it intended to be, and to assume that homebuyers openly and with full knowledge surrendered their rights to these protections cannot be argued with any substance. The arguments fall on constructive notice of equitable servitudes is sufficient notice, but that is where the application of equitable servitudes vs. explicit waiver of civil rights fails to provide a just remedy.

Should public policy uphold the current doctrine that equitable servitudes are binding contracts that are agreed to by a purchaser when title to his home is accepted? Shouldn't there be legislation to protect average citizens, home buyers and not experienced real estate investors, from this constructive notice binding of a waiver and surrender of rights enjoyed by other home buyers? Shouldn't there be legislation that calls for an explicit waiver of such rights after being fully informed of the consequences and impact of buying in a CID? Current disclosure laws fall far short of a comprehensive "red herring" warning to perspective buyers.

> A waiver of constitutional rights must be voluntary and intelligent, it must have been made knowingly, and with sufficient awareness of the relevant circumstances and likely consequences. Stated otherwise, a valid waiver connotes an intentional relinquishment or abandonment of a known right or privilege. Certainly, a waiver may not rest on mistake or ignorance.
>
> 16 C.J.S. *Constitutional Law* § 82.

Second, I ask, "Why is it necessary to define a CID, if it were only a property interest alone, in terms of mandatory membership with the right to lien homeowner private properties?" Draft § 4095(2)(b).

> In a development where there is no common area other than that established by mutual or reciprocal easement rights appurtenant to the separate interests, "common interest development" means a development in which a separate interest is coupled with membership in an association with the power to enforce an obligation of an owner of a separate interest with respect to the beneficial use and enjoyment of common area by means of an assessment that may become a lien upon the separate interest.

Is the state of California, by virtue of this definition of a common interest development, conferring governmental status on CIDs by including only those CIDs that levy assessments and lien homeowner properties? Since the existence of a CID depends upon its right to assess its members, then the wording of this section can only be construed as a requirement to lien a homeowner's property in order to qualify as a CID. However, there are no protections, as stated in my email letter of March 14th, against the excessive punishment of homeowners resulting from the foreclosures of these liens for amounts far in excess of any compensatory damages to the CID. The draft of Civil Code § 400 et seq. is without sufficient due process protections to avoid state actions resulting from the acts of private parties and to avoid a violation of 42 U.S.C. § 1983, "color of law" violation of rights." This amounts to a taking of property by private organizations under state action. (See references in my March 14th letter).

Finally, I am very much concerned with the continued deference given to CIDs by the proposed § 6175(a), Liberal Construction of Instruments, unchanged from former § 1371, which says,

> Any deed, declaration, or condominium plan for a common interest development shall be liberally construed to facilitate the operation of the common interest

development, and its provisions shall be presumed to be independent and severable.

Here, the CID is indeed being treated and held to the level of a state agency, a municipal entity, where it is well established that deference to government agencies is given by the courts. This provision invalidates the equal protection clause since, as stated above, there are no protections in place in similar, at least, to those available to any citizen with respect to agency adjudication under California's Administrative Procedures Act. This provision gives unrestrained powers to the CID without the prerequisite balance of homeowner protections as required under the law. It is tantamount to saying that CIDs, being private contractual arrangements, are outside the 14th Amendment protections. This cannot be allowed. If upheld, the state is saying that private organizations can bypass the laws of the land by creating privately contracted governments.

I well understand that the focus of your current endeavors may not be in alignment with my views, but if the principles of the California and US Constitutions are to be upheld, CLRC must begin to take serious consideration of these views. Planned communities, CIDs, territories privately governed, cannot be treated solely as a property interest and the laws must reflect this concern. CIDs are governments and the laws must reflect their civil government functions. The special interests have argued, following Marsh v. Alabama, that CIDs possess functions found in many other non-governmental entities and, therefore, they are not governments. Yet, the laws commonly refer to local governments as being incorporated as **municipal corporations.** Distinctions are even made with respect to governmental immunities on the basis of governmental and proprietary functions, "proprietary" meaning a function that can be performed by a private corporation, such as trash removal. Cf. Prosser & Keeton, Prosser and Keeton On Torts, *Government Immunities*, § 131 (1984). CID legislation has failed to recognize this dual nature of local government and proposed legislation must place proper emphasis on the neglected civil government aspects of CIDs.

> "[A]nd upon analysis of the association's functions, one clearly sees the association as a quasi-government entity paralleling in almost every case the powers, duties, and responsibilities of a municipal government. As a 'mini-government,' the association provides to its members, in almost every case, utility services, road maintenance, street and common area lighting, and refuse removal."
> . . .
>
> With power, of course, comes the potential for abuse. Therefore, the Association must be held to a high standard of responsibility: "The business and governmental aspects of the association and the association's relationship to its members clearly give rise to a special sense of responsibility upon the officers and directors.... This special responsibility is manifested in the requirements of fiduciary duties and the requirements of due process, equal protection, and fair dealing." (Id at p. 921.) (See Raven's Cove Townhomes, Inc. v. Knuppe Development Co.,supra, 114 Cal.App.3d 783, 792-799.) **[142 Cal.App.3d 652]**
>
> Cohen v. Kite Hill Community Assn. 142 Cal.App.3d 642 , 191 Cal.Rptr. 209 (1983) (citing Hyatt and Rhodes, *Concepts of Liability in the Development and*

Administration of Condominium and Home Owners Associations 12 Wake Forest Law Review at page 915 (1976)).

What is the legitimate purpose of the state to justify the taking from homeowners and the giving to CIDs?

> Equal protection principles require that distinctions drawn by a statute granting an economic benefit to one class while denying it to another must at least bear some rational relationship to a conceivable legitimate state purpose.
>
> 16B Am. Jur. 2d *Constitutional Law* § 873.

California Constitution,

> Article1, Sec. 7. (a) A person may not be deprived of life, liberty, or property without due process of law or denied equal protection of the laws . . . .
>
> Article 4, Sec. 16. (a) All laws of a general nature have uniform operation. (b) A local or special statute is invalid in any case if a general statute can be made applicable.

Respectfully,

George K. Staropoli
President