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LEGISLATIVE & CASE LAW UPDATE (2005)

This year the community association industry has experienced change, both from Sacramento and the Courts. The governor signed several bills significantly affecting the operation and management of community associations. The Courts have rendered decisions both expanding and limiting associations' rights.

Legislation

VOTING BY SECRET BALLOT - SB 61 **(Civil Code Section 1363.03 - effective July 1, 2006)**

The law has always allowed associations wide latitude and discretion with respect to holding elections and voting on ballot measures. For the most part, an association was required to adhere to its Bylaws, general rules of parliamentary procedure and general election/voting laws set forth in the *Corporations Code*.

Now, with the passage of Senate Bill 61 (*Civil Code Section 1363.03*), the election and voting processes are more onerous on associations, especially with respect to the use of secret ballots for the election of directors, approval of assessments and assessment increases, amendments to governing documents and the grant of exclusive use common area to a member. In addition, inspectors of election must be appointed to tally votes and make decisions regarding the legitimacy of the vote. Below is a summary of the requirements mandated by this new bill.

I. Required Election Rules

Associations shall adopt rules that address, at a minimum, the following:

1. Give all candidates and members equal access to association media, newsletters or internet web sites, during a campaign, for purposes that are

reasonably related to that election. The Board does not have the authority to edit the content of these communications.

2. Ensure access to common area meeting space, during a campaign, to all candidates at no cost.
3. Specify the qualifications for candidates for the board of directors and procedures for nomination of candidates. Nomination procedures are unreasonable if they prohibit any member from nominating themselves.
4. Specify the qualifications for voting, the voting power of each membership, the authenticity, validity and effect of proxies and the voting period for elections including the times at which polls will open and close. *Note, see paragraph 115 below regarding the use of proxies.*
5. Specify a method of selecting one or three inspectors of election.
6. The inspectors of election shall do the following:
 - A. Determine the number of membership entitled to vote and the voting power of each
 - B. Determine the authenticity, validity and effect of proxies
 - C. Receive and maintain custody of ballots. Custody of the ballots shall be transferred to the association after tabulation of the vote
 - D. Hear and determine all challenges and questions
 - E. Count and tabulate votes
 - F. Determine when the polls shall open and close
 - G. Determine the result of the election

II. **Secret Ballots**

7. Notwithstanding any other law or provision of the governing documents, an election within a common interest development regarding assessments, election of board members, amendments to the governing documents, or the grant of exclusive use common area property pursuant to *Civil Code* Section 1363.07 shall be held by secret ballot.
8. A ballot and two pre-addressed envelopes with instructions on how to return the ballot must be delivered or mailed to every member 30 days prior to the election. Voters may not be identified by name, address, or lot, unit or parcel numbers.
9. To ensure confidentiality associations shall see that the following occurs:
 - G. The ballot itself is not signed by the voter, but is inserted into a sealed

envelope. The envelope must be inserted into a second sealed envelope. In the upper left hand corner of the second sealed envelope the voter must print or sign his or her name.

H. All votes shall be counted and tabulated by inspectors of election in a public and properly noticed open meeting of the board of directors or members. Based on this requirement, there must be a quorum at any such meeting for the inspectors to conduct business and tabulate the votes. Based thereon, it would be wise for boards to notice a special meeting of the board after membership meetings in case a quorum of the members is not achieved; then, boards can have the election results finalized at the noticed board meeting.

4. Within 15 days of the vote, boards shall publicize the results of the vote in a communication directed to all members.

5. NOTE: *Civil Code* Section 1363.03 does reference proxies; however, proxies cannot be used while complying with the secret ballot process. Therefore, proxies, in our opinion, can only be used for matters other than assessments, election of board members, amendments to the governing documents, or the grant of exclusive use common area property.

III. Association Funds for Campaigns

Civil Code Section 1363.04 provides that association funds shall not be used for "campaign purposes." The term "campaign purposes" is broadly defined.

IV. Penalties for Violations

Civil Code Section 1363.09 provides that:

4. A member of an association may bring a civil action for declaratory relief for a violation of this article by an association, including injunctive relief, restitution or a combination thereof.

5. A member who prevails in a civil action to enforce his/her rights pursuant to this article shall be entitled to reasonable attorney's fees and court costs, and the court may impose a civil penalty of up to \$500 for each violation. A prevailing association shall not recover any costs, unless the court finds the action frivolous or unreasonable.

ASSESSMENT COLLECTIONS; RECORDING AND FORECLOSING LIENS - SB 137 (Civil Code Sections 1363.001, 1367.1, 1367.4, 1367.5 - effective January 1, 2006)

I. Introduction - Civil Code Section 1365.1

In the past, associations have been able to lien and foreclose on liens without a monetary minimum requirement for delinquencies. Now, pursuant to *Civil Code* Section

1365.1, an association may only commence foreclosure proceedings, judicial or nonjudicial, if the delinquency is \$1,800.00 or more than 12 months delinquent, whichever occurs first.

Specifically, Section 1365.1 states, in pertinent part, that for all liens recorded on or after January 1, 2006, associations cannot use judicial or nonjudicial foreclosure to collect said assessments if the delinquent amount, exclusive of any accelerated assessments, late charges, fees, attorney's fees, interests and costs of collection, is less than \$1,800.00 or less than 12 months delinquent.

Practically speaking, this section makes assessment collections much more difficult and burdensome, and forces associations to use small claims court, which limits associations' rights. This section also forces associations to allow delinquencies to accrue for a year and/or a minimum of \$1,800.00, which may prove to be a financial strain. Also this section requires associations to offer internal dispute resolution ("IDR") to an owner prior to recording a lien. In addition, associations must offer IDR and alternative dispute resolution ("ADR") prior to foreclosing on a lien.

II. Notice to Homeowners

In addition to the requirements already set forth in Civil Codes Sections 1367.1(a)(1)-(4), this section also requires associations to advise delinquent owners of the following:

1. The right to dispute the debt by submitting a written request for dispute resolution to the association pursuant to the IDR procedure set forth in *Civil Code* Section 1363.810.
2. The right to request ADR with a neutral third party pursuant to *Civil Code* Section 1369.510.

III. Decision to Lien

For liens recorded on or after January 1, 2006, the new law requires decisions to record a lien to be made by the Board of Directors in an open meeting and the Board's vote must be recorded in the minutes of the meeting. The decision to record a lien cannot be delegated to an agent of the association, such as a community manager.

An itemization of the delinquency at the time of the recordation of the lien must now also be recorded with the lien.

IV. Right of Redemption

Current law states that there is a right of redemption for judicial foreclosures. The new law now provides for a 90 day right of redemption for nonjudicial foreclosures.

V. Small Claims Court

The new law allows an association's representative, i.e. a community manager or bookkeeper, to represent the association in small claims court on collection cases. This was intended to take the burden of attending small claims court hearings off volunteer board members and allows associations to delegate same to its agents.

VI. Release of Lien

The new law states that associations must release a lien within twenty-one (21) days after receipt of payment in full from the delinquent homeowner.

VII. On-Line Education Course

Civil Code Section 1363.001 provides that, if funds are available, the Department of Real Estate and Department of Consumer Affairs shall develop an on-line education course for boards of directors of associations regarding the roles, duties, laws and responsibilities of board members and the nonjudicial foreclosure process.

INSPECTION OF ASSOCIATION RECORDS; GRANT OF EXCLUSIVE USE COMMON AREA - AB 1098 (Civil Code Sections 1365.2, 1363.07 - effective July 1, 2006)

I. Introduction - Civil Code Section 1365.2

Pursuant to current law, a member is entitled to inspect and copy very limited association records, specifically, financial books and records and minutes of meetings (other than executive session meeting minutes). The new law repeals and replaces the current *Civil Code* Section 1365.2, and expands the type of documents a member is entitled to inspect. Specifically, Section 1365.2 states, in pertinent part, as follows:

The types of documents subject to inspection by members are “association records” and “enhanced association records”, which are defined as follows:

II. “Association Records”

1. Any financial document required to be provided pursuant to *Civil Code* Section 1365
2. Any financial document required to be provided pursuant to *Civil Code* Section 1368
3. Interim, unaudited financial statements containing any of the following
 - a. Balance sheet
 - b. Income and expense statement
 - c. Budget comparison
 - d. General ledger
4. Executed contracts, not otherwise privileged under law
5. Written board approval of vendor or contract proposals or invoices
6. State and Federal tax returns
7. Reserve account balances and records of payments made from

reserve accounts

8. Agenda and minutes of meetings of the members, the board of directors and any committee appointed by the board of directors, excluding, however, agenda, meeting minutes and other information from executive session meetings of the board
9. Membership lists, including names, property addresses and mailing addresses, if the member requesting the list states in writing the purpose of the request, which must be reasonably related to the requester's interest as a member. In addition, a member may opt out of the sharing of his or her name, property address and mailing address by notifying the association in writing
10. Check registers

III. "Enhanced Association Records"

1. Invoices, receipts and canceled checks for payments made by the association, purchase orders approved by the association, credit card statements for credit cards issued in the name of the association, statement for services rendered, and reimbursement requests submitted to the association (provided that the person submitting the reimbursement request shall be responsible for removing all personal identification information for the request).

IV. Time Frame for Making Records Available

Association records must be made available for the current fiscal year and for the two previous fiscal years. In addition, board meeting minutes and member meeting minutes must be made permanently available.

1. Associations must either make available for inspection or provide copies of association records and enhanced association records for the current fiscal year within ten (10) days of receipt of the member's request
2. Associations must either make available for inspection or provide copies of association records and enhanced association records for the previous two fiscal years within thirty (30) days of receipt of the member's request
3. Minutes of meetings of committees with decision-making authority for meetings commencing January 1, 2007, within 15 calendar days following their approval

V. Costs of Providing Requested Documents

The Association may charge requesting members for the following:

1. The direct and actual cost for copying and mailing the documents
2. The time actually and reasonably involved in redacting association records and enhanced association records, at a rate of \$10.00 per hour, not to exceed

\$200 total.

3. Associations must advise requesting members of the costs prior to incurring same and must obtain the requesting member's approval to pay before proceeding with the collection and copying of the requested documents

VI. Redaction of Documents and Prohibition Against Commercial Use

Associations may withhold or redact information if:

1. The release of information is likely to lead to identity theft
2. The release of the information is likely to lead to fraud in connection with the association
3. The release of the information is privileged under the law
4. The release of the information is likely to lead to the compromise of the privacy of an individual member.

The new law also states that association records obtained by members may not be sold or used for commercial purposes.

VII. Who May Inspect or Copy

Civil Code Sections 1365.2(b)(1) and (2) provide that a member or any person the requesting member designates, in writing, as the member's representative, may inspect association records and enhanced association records.

VIII. Granting of Exclusive Use of Common Area

Civil Code Section 1363.07 states that, unless an association's governing documents state otherwise, approval of 67% of the members is needed if an association, through its board of directors, desires to grant a member exclusive use of any portion of common area held by the association in fee.

1. Exception to Member Approval

However, member approval is not necessary under the following circumstances:

- a. If the grant of an exclusive easement is to correct errors.
- b. If the grant of an exclusive easement is to transfer the responsibility of maintenance of "inaccessible" common area(s).

The vote for transfer of exclusive use common area must be done by secret ballot and the voting materials must advise whether or not the association will be compensated for the exclusive easement and whether the member receiving exclusive use will be providing insurance coverage for the common area in question.

Case Law

Woodridge Escondido Property Owners Association v. Nielsen

Woodridge Escondido Property Owners Association brought an action against Nielsen for both declaratory and injunctive relief to enforce the CC&Rs prohibiting the construction of permanent structures on an owner's side yard easement. In this case, the improvement was built with the written permission of the Architectural Committee, however, the Board later decided that this improvement violated the CC&Rs. The owner's contention was that the Board acted arbitrarily in ordering the removal of his deck once it had already been approved by the Architectural Committee, and he relied upon that approval.

The court held that the Committee had no authority to approve construction expressly forbidden by the CC&Rs and that the Board acted properly, despite the fact that the Architectural Committee had approved the construction. One issue not addressed was the fact that the Association could be estopped from seeking removal of the deck based upon the owner's reliance and approval by the Architectural Committee. Thus, this case stands for the following provisions:

1. An Architectural Committee may not approve construction that would expressly violate a CC&R provision, if it does, the Board has an affirmative duty to intervene and can succeed even if the owner has finished the work in reliance on the Architectural Committee's approval;
2. The Board should afford the owner a hearing before making such a decision.

One important note is that the court did not comment on whether the fact that the Association offered to pay for the removal of the structure was a factor in its decision.

Brown v. Professional Community Management, Inc.

A homeowner brought a cross-complaint against the association property manager and her association claiming that she and other members of the association were charged transfer fees exceeding the amount necessary to defray the costs for which the fees had been levied (through escrow), and that the association and the manager violated Civil Code Section 1366.1. The court concluded that this statute prohibits a homeowners associations from imposing or collecting excessive assessments or fees, not management companies. In light of the fact that the management company has no duty under the statute, the court dismissed the complaint against the management company.

O'Toole v. Los Angeles Kingsbury Court Owners Association

Los Angeles Kingsbury Court Owners Association ("Association") failed to pay a civil judgment in favor of James O'Toole ("O'Toole"), an insurance adjuster hired by the Association to adjust the Association's earthquake claim (following the 1994 Northridge Earthquake). O'Toole sought and received a court order appointing a receiver and compelling the Association to levy a special emergency assessment. The Association appealed the trial court's order. The Court of Appeal affirmed the order and held the

Association was required to levy a special emergency assessment to satisfy the civil judgment.

The Association retained legal counsel (Rapkin Gitlin & Beaumont) to appeal the trial court's ruling. The question before the Appellate Court was whether an association can be compelled to levy a special emergency assessment to satisfy a judgment.

The Court held that pursuant to *Civil Code* Section 1366, the Association had the power and duty to levy a special emergency assessment to pay for extraordinary expenses arising from a court order. In addition, the Court held, the Association's general duty to maintain common area included a more specific duty to meet its legal obligations. The Court held that the statutory exemption in *Civil Code* Section 1366 applied only to regular assessments for essential services, not a special emergency assessment levied to pay for extraordinary expenses arising from a court order.

The Court rejected the Association's legal arguments that: the Association's refusal to pay a civil judgment was a "business decision" protected by the business judgment rule articulated in *Lamden v. LaJolla Shores Clubdominium Homeowners Association*, 21 Cal. 4th 249; and a special emergency assessment will transform homeowners into judgment debtors and dissuade consumers from buying into community associations. The Court reasoned that if associations were allowed to use the exemption created in Section 1366 to avoid paying vendors and service providers, such as O'Toole, contractors may shy away from conducting repairs if they are left with little remedy in the event an association breaches a contract.

Inco Development v. Dennis Haynes

Numerous homeowners filed a construction defect lawsuit against Inco Development. Inco moved to dismiss the lawsuit by way of a summary judgement motion on the grounds that the 10-year statute of limitations under Code of Civil Procedure Section 337.15 for latent defects barred the action as to 157 of the 216 homes involved in the case.

Inco filed bankruptcy on October 15, 1999. The bankruptcy action was dismissed and the stay was lifted on May 24, 2001. The plaintiffs argued that the statute of limitations was tolled for the 19 month period during which the stay was in effect. The trial court denied the summary judgement. The appellate court reversed.

The Court held that the 10 years period in Section 337.15 imposes an absolute requirement that a lawsuit to recover damages for latent defects be brought within 10 years of substantial completion of the construction. The Court reasoned that the legislative intent, at the time it adopted Code of Civil Procedure Section 337.15, was to ensure a generous but firm cutoff date for latent defect suits. Thus, the Court concluded that Section 337.15 was a statute of repose, and that no motion could be brought after 10 years for whatever reason, even a bankrupt developer.

Tilley v. CZ Master Association

Donal Tilley, a security guard employed by BonaFide Security Services, sued CZ Master Association, which had contracted with Bona Fide for security services, because he suffered an assault while responding to a complaint about a party on CZ's premises. Tilley argued that CZ owed the security guards a duty to provide safe premises, including

imposing restrictions to control youth parties, that it acted negligently by failing to do so, and that it increased the danger to the guards by requiring them to work unarmed and to respond personally to complaints about such parties.

The trial court granted summary judgment in CZ's favor because CZ had no liability for the injuries suffered by the employee of an independent contractor. Also, the Court reasoned that CZ owed Tilley no duty to restrict access to the community's premises and Tilley had assumed the risk of the injuries he suffered. The appellate court affirmed the judgment of the trial court.

The court reasoned that CZ did not have a duty to restrict access to the community or to regulate the parties hosted by its residents because parties are not considered to be "inherently dangerous." In addition, CZ hired Tilley to confront the very hazard which resulted in his injury and would thus exonerate CZ from any duty to protect him from that hazard pursuant to the assumption of risk doctrine.

Acosta v. Glenfed Development Corp

In a construction defect case, the trial court granted summary judgment in favor of a developer/contractor on the grounds that 47 of the 59 named plaintiffs had been brought into the case more than 10 years after the recordation of notices of completion of the work of improvement. Plaintiffs appealed and argued that the defects appeared to be the result of willful misconduct by defendants in that they were "so serious and prevalent" that they were either the result of a deliberate decision to cut corners for cost savings or the result of a near total, virtually reckless, failure by the developer to adequately supervise subcontractors. The appellate court reversed.

The appellate court reasoned that the plaintiffs did not need to prove that GlenFed knew about the defects or acted willfully. The appellate court concluded that GlenFed could be held liable for the willful misconduct of others involved in the project more than 10 years after completion of the construction. The Court went on to say that GlenFed, as the developer and general contractor, owed a non-delegable duty to supervise the work of its subcontractors. The Court relied on the general rule that the willful misconduct of an agent, such as a subcontractors, is imputed to the agent's principal, i.e., the general contractors.

The holding in this case is likely to encourage the filing of more construction defect cases on older buildings or it allows limited cases for latent defects to be filed more than 10 years after recordation of the notice of completion.

Roe v. McDonald's Corp

A customer sued McDonalds for the restaurant's failure to protect her against someone who she reported to the restaurant management as looking like a sex maniac from a subsequent sexual attack in the restaurant's restrooms. The appellate Court held that the risk was not sufficiently foreseeable because there is a huge difference between making eyes at a woman and a physical assault on her in a restroom.

This case may be applicable to associations and a court may rule on the liability of an association by imposing this holding through analogy. If the Roe holding is followed, an association will likely not be held liable for risks and danger to homeowners, tenants, invitees that are not reasonably foreseeable. In the instant case, the Court held that sexual looks do not constitute a foreseeable threat of physical assault.

Koebke v. Bernardo Heights Country Club

This is a case involving a lesbian couple who are registered domestic partners. The Bernardo Heights Country Club refused to extend them certain benefits extended to married members of the Club. The Plaintiffs alleged that this action constituted marital status discrimination under the Unruh Civil Rights Act. The court applied the California Domestic Partners Rights and Responsibilities Act in conjunction with Unruh. The California Supreme Court held that the Unruh Act prohibits discrimination against registered domestic partners in favor of married couples. The court agreed with the Plaintiffs that marital status involves a personal characteristic like Unruh's specifically protected groups.

Doheny Park Terrace Homeowners Association, Inc. v Truck Insurance Exchange

This case involves an insured condominium homeowners association (Doheny Park Terrace) which brought an action against its property insurer (Truck Insurance) for breach of contract, breach of the implied covenant of good faith and fair dealing (bad faith) and fraud, after the insurer refused to pay a claim for property damage caused by the 1994 Northridge earthquake. The court initially dismissed the Association's complaint, concluding that the Association's action was not timely filed and that the Association failed to plead facts sufficient to establish equitable estoppel. The Association appealed this ruling despite the fact that the Association brought this action beyond the contractual two year limitation period and beyond the special one year period for filing suit against insurers for losses sustained in the Northridge Earthquake. The Association was successful in establishing the doctrine of equitable estoppel by alleging that it relied on Truck Insurance's determination that the Association's damages were less than the cost of its deductible and only after it retained its own expert, which was after the applicable limitation period had run, did it discover that its damages actually exceeded its deductible. The court went on to state that the special one year extension did not take the place of the doctrine of equitable estoppel as to time barred action. However, because the statute was silent as to the applicability of equitable estoppel, the court interpreted the language and the legislative history which indicated an intent to preserve equitable estoppel so as to benefit an insured who had suffered as a result of an insurer's misconduct.

Zabrucky v McAdams

Plaintiffs filed suit against neighboring land owners who were adding a one-story addition to their home. Plaintiffs claimed that the addition would obscure their view of the ocean and violate the CC&Rs, which restricted the height of fences, hedges, trees or other landscaping, or any structure erected that may at present or in the future obstruct the view from any other Lot. In addition, the CC&Rs permitted only single family dwellings except that two story structures were permitted with approval by the Architectural Committee, if the dwelling did not detract from the view of any other Lot. After the court reviewed other cases addressing similar language in the CC&Rs, the court concluded that the reasonable intent of the CC&Rs drafters was not to completely prohibit dwelling units from being enlarged beyond their original footprints in the side yards and setback areas, but rather to prohibit only unreasonable intrusions on the view of other residents in the subdivision. Thus, this case stands for the proposition that a home renovation must not unreasonably obstruct the view of another owner, so long as views are protected in CC&Rs.

Berger v California Insurance Guarantee Association

This case arises out of an insurance claim for damages resulting from the Northridge earthquake against an insurer who became insolvent. The court held the California Insurance Guarantee Association (CIGA) is responsible for paying otherwise time barred claims arising from the Northridge earthquake against an insolvent insurer that are revived by special statute. However, CIGA's responsibility to administer claims that are revived by a special statute does not make CIGA liable, directly or indirectly, for the wrongful acts of the insolvent insurer and in no way undermines its statutory immunity from liability for the wrongful acts of the insolvent insurer.

Property Owners of Whispering Palms, Inc. v Newport Pacific, Inc.

An association of residents in two standard subdivisions (i.e. those not having any areas of common ownership) sued the developer that retained control over the Architectural Committees responsible for enforcing the subdivision's CC&Rs. Initial judgment was rendered in favor of the developer and was appealed by the association, raising two primary issues: (1) whether the association has standing to sue because its membership included residents of another subdivision, which would have no standing to assert such a claim in their own right; and (2) whether the regulation governing the developers obligation to turn over control of an Architectural Committee to a subdivision's association are applicable to a standard subdivision.

The court held that the fact that the association's membership included some residents who did not have an interest in the asserted claims did not deprive the association of standing to bring action on behalf of residents who did have such interest with regard to the regulation relating to the developer's obligation to turn over control of the Architectural Committee to the subdivision's homeowners. The court found that it was inapplicable to a standard subdivision where the residents had no areas of common ownership.

Bear Creek Master Homeowners Association v. Edwards

Bear Creek Master Homeowners Association brought an action for foreclosure and breach of contract against the owner of a parcel for failure to pay assessments for eight condominium units that were planned for the parcel but had not yet been built. The court held that the owner was required to pay the association's assessments even though the structures had not yet been built because the Davis-Stirling Act defined condominium as "an interest in space" and thus did not require a complete building. Under both the Davis-Stirling Act and the applicable CC&Rs, assessments become due upon all units in a phase after the first unit in a phase has been sold. Here, the defendant's property was purchased after the first unit had been sold, thus, the triggering of assessments took place.