WHAT HAPPENS WHEN BOARDS VIOLATE DAVIS-STIRLING?

AND IS THERE SUCH A THING AS "CONDO POLICE?"

BY STEVEN S. WEIL, ESQ. AND ANDREA L. O'TOOLE, ESQ.

INTRODUCTION

The Davis-Stirling Common Interest Development Act ("Act") has an awful lot of "dos and don'ts": send out a budget, estimate reserves, hold hearings, offer mediation, create a collection policy, don't lien without a meeting, etc. But what happens if a board doesn't comply with all these mandates? Will directors who do not comply be removed from office, fined, arrested, or put in jail? If so, by whom? Fellow directors? An association committee? The Department of Real Estate, or the Attorney General? The District Attorney? The Condo Police? This article explores the issues.

BACKGROUND

Common Interest Developments (or "CID," the term used to describe most homeowner and condominium associations in our state) are required by law to be operated in accordance with the Act. Most CIDs are also non-profit mutual benefit corporations and thus are subject to various provisions of the Nonprofit Mutual Benefit Corporation Law. CIDs are subject to a host of other state laws, including the Unruh Civil Rights Act and the Fair Employment and Housing Act (these latter two generally deal with discrimination).

The subject of whether boards of directors comply with all of these laws is the subject of much interest on the internet, websites, and in e-newsletters. With such interest comes a great deal of scrutiny and claims that, in fact, directors do not comply with the laws. Frequently, association members seek relief from the California Department of Real Estate or the state Attorney General or even ECHO or sue for relief in Superior Court or its Small Claims division. Others simply think they are entitled to remedies for legal violations without taking any action whatsoever. Let's start by dispelling some myths and rumors.

THE DEPARTMENT OF REAL ESTATE AND THE CALIFORNIA ATTORNEY GENERAL

Many are surprised to learn that the California Department of Real State (DRE) plays a fairly limited role when it comes to enforcing the Act or other perceived board improprieties. When it comes to CIDs, generally the DRE's function is to protect purchasers from fraud or misrepresentation in connection with sales of lots or units in a CID.

During the early stages of a project – until 25% of the properties are sold – any amendment to the governing documents to change how the association operates requires the DRE consent. (See Business & Professions Code §11018.7) After that, DRE consent is not required. Here is what the DRE website (www.dre.ca.gov/sub_faq_cid.html) says about its power to deal with CID disputes:

Q: *What about homeowner associations disputes?*

A: *We suggest that members refer to their governing documents (Articles, Bylaws, Declaration, etc.) for dispute resolution remedies. The California State Attorney General's office provides some oversight for incorporated homeowner associations. Depending on the nature of the problem, you may consider seeking the advice of a private attorney or contacting your local district attorney's office.*

If the subdivider still owns interests within the project, we recommend that the association and/or owners contact the Department of Real Estate for possible assistance. The Department's powers are generally limited to preventing the subdivider from marketing the remaining units in the project, if wrongdoing is substantiated.

While the DRE can, if it determines that misrepresentations or other violations of relevant regulations and laws have been violated (Business & Professions Code §11019), issue a "Cease and Desist Order" to bar a subdivider from continuing to sell property, the DRE itself is not charged with enforcement of the Act against "homeowner" directors.

While the California Attorney General ("AG") may be the "Chief Law Enforcement Officer" of our state, the AG's department generally will not enforce the Act. In theory, the AG will investigate alleged violations of the Corporations Code (typically complaints that boards have refused to hold meetings or permit inspection of records) but, in reality, no one in the field consulted by this author has ever heard of the AG actually doing more than simply passing a member's objection on to the CID and requesting a response. As a practical matter, there appears to be no follow up.

The AG's office may be more active when it comes to discrimination complaints. A CID may not unlawfully discriminate in the provision of services or the enjoyment of housing benefits under the Fair Employment and Housing Act at Government Code §12900 et seq (FEHA). The AG can enforce that and similar laws prohibiting unlawful discrimination on the basis of a protected class status. For example, the Act (at Civil Code §1360) prohibits an association from unreasonably denying a resident the ability to modify a condominium unit to facilitate access for the disabled. The violation of this law, being a probable violation of FEHA as well, could be acted upon by the AG. FEHA violations can include imposition of compensatory and punitive damages, an award of attorney fees and costs, and other remedies.

Finally, it is doubtful that homeowners claiming their boards have violated the Act will get relief from the local District Attorney ("DA"). The DA prosecutes those who violate criminal laws. Other than a claim that directors have embezzled funds, the DA will probably not enforce the kinds of laws that affect most CID operations.[1]

PENALTIES FOR VIOLATION OF THE DAVIS-STIRLING COMMON INTEREST DEVELOPMENT ACT

While the Act has almost 100 statutes (not including all its subparts), very few contain "punishments" for their violation. Here are some that do:

Distribution of the Budget – Assessment Increases by Board Action – Self Policing

A CID board can, without membership approval, increase annual assessments up to twenty percent (20%) and can impose a special assessment of up to five percent (5%) of budgeted gross expenses. But, under §1366(a)[2] this "taxing power" only exists if the board has, between thirty (30) and ninety (90) days prior to the beginning of the fiscal year, distributed the annual budget. That disclosure, under §1365(a) includes the budget, summary of reserves, percentage of funding and deficiency, representations concerning adoption of funding plans, existing loans, and procedures relating to reserve calculations.

If the board has not timely complied with its annual budget disclosure obligations, assessment increases and special assessments (perhaps other than for emergencies) require the approval of a simple majority of members. The failure to comply with the law can have a significant and negative impact on operations. At a minimum, a costly election with an uncertain outcome will be needed to finance expected services and reserve contributions. And, if owing to apathy or opposition the members' consent cannot be obtained, the board and reserve study preparer will have to revise their projections. Services may have to be cut. Reserve borrowing may be required. Claims, or at least certainly embarrassment and expense, will ensue.

Membership Inspection Rights Protected in Small Claims Court

While CID directors have the absolute right to inspect all association records and property under Corporations Code §8334, member inspection rights are limited and defined in §1365.2. A member (including their agent, like an attorney) may inspect (and that includes the right to copy) documents ranging from minutes and the membership list to the management contract and copies of checks and invoices. A proper request might include some records that, if disclosed, could result in identify theft or breach of privacy rights. An association and its officers, directors, and agents (that would include

managers and in-house management employees) can be held liable for damages resulting from the distribution of such information, or the failure to "redact" the information if the disclosure was intentional, willful, or simply negligent. (§1365.2(d)(3)) And, a member may enforce their basic records inspection rights by suing in Small Claims Court. If it finds that the withholding of records was unreasonable, the Court shall award reasonable costs and attorney fees and may impose a civil penalty of up to $500 for each records request. (But, if the association wins the suit, it will not be entitled to its attorney fees unless it can show that the owner's suit was frivolous, unreasonable, or without foundation).

Election Law Violations: Rescinding Votes and Awarding Damages

Not only did the legislature introduce a whole new set of voting requirements when it adopted the series of election laws starting with §1363.03, it authorized many of those requirements to be enforced in Small Claims Court (a forum which does not require nor, until an appeal, permit legal representation) while others still must be pursued in Superior Court.

The remedies for improper conduct – the violation of the various election laws – can be severe. Remedies include: voiding the results of any election of directors or action taken by the board of directors; injunctive relief requiring the association to conduct new votes, hold new meetings, or distribute documents; monetary awards for damages or "restitution" (for, as an example, the improper use of association funds for campaigning); imposition of a civil penalty of $500 for each violation; and, recovery of attorney fees and costs. The range of issues subject to these remedies include election votes to authorize assessment increases, governing document amendments, grants of exclusive use common area, and the election of directors. They also include actions arising out of the use of association funds for campaigning and for violations of the Open Meeting Act (including the failure to properly post agendas or the approval of corporate action) (see §1363.05). A member can, under §1363.09, obtain relief in Small Claims Court for claims relating to access to association resources by a candidate or a member expressing a point of view on a matter being voted upon, or relating to ballot and ballot counting issues.

ENFORCEMENT OF OTHER RIGHTS

Penalties under the Vehicle Code

CIDs may tow vehicles as authorized by Vehicle Code §22658. It is not an association-friendly law. Its many specific requirements are deceptively difficult to implement properly. The failure to do so can come at great cost. An association (or their agent) who fails to comply with some of the notice requirements may be guilty of a criminal infraction punishable by a fine of one thousand dollars ($1,000).[3] Towing company violators are subject to even worse penalties for failing to follow the statute including fines of up to $2,500 and/or imprisonment for up to three (3) months. (Vehicle Code §22658(l)) Damages actually sustained by someone as a result of an improper tow can also be awarded.

Disclosures to the State

Section 1363.6 and Corporations Code §8210 require an association to make certain disclosures to the Secretary of State of the names of the directors and officers of the corporation and changes to the association's street address. The address of the manager and other similar information must also be provided. Failure of an incorporated association to comply has very bad (not to mention embarrassing and inconvenient) consequences. They include suspension of the association's corporate status which, in turn, means the association cannot use the courts to pursue or defend claims or take advantage of the "corporate shield" that might otherwise immunize directors and members from personal liability for claims against the association. Also, contracts entered into by the incorporated association during the period of its suspension are voidable. And, on the embarrassing side, when a corporation's status is suspended for failure to comply with these reporting requirements, it could permanently lose its name if, in the meanwhile, the name is registered for another project.[4]

Corporate Formalities

While the AG may have little interest or funding to pursue violations of the Corporations Code, members can do so by bringing suit on their own. In the appropriate case, a Court can compel an association to hold a meeting when it refuses; dictate quorums; cause the removal of directors; and award attorney fees and costs for violations.

SUMMARY

Pursuing many types of violations of Davis-Stirling and other laws affecting homeowner associations does not require attorneys. Some are self-executing (like the ban on assessment increases), while others can be pursued in Small Claims Court. And, while some government agencies have some oversight of California CID operations, that oversight is narrow and they will not "police" board action. The most potent enforcement tool however may the political one. An educated membership taking advantage of the internet and trade publications can and should hold boards to high standards of compliance with the law. Directors that fail to do so - aside from putting themselves and their associations at risk - are subject to the highest form of penalty: rejection by the membership and removal from power.

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[1] We've encountered two situations in the last year in which the DA did get involved in affairs affecting firm clients. In one, a director obtained an injunction barring a member from harassment, including contacting that director by email. The injunction was violated and the DA is pressing charges. In another, an association's treasurer stole about $150,000 in reserve funds, admitted the crime, and was prosecuted by the DA. More recently, we've got a client who requested that the police charge with a crime a director who stole funds but, to date, the authorities have not done so, citing the fact that the director has fled the country.

[2] Unless otherwise indicated, all further statutory references are to Civil Code provisions contained in the Act.

[3] Here is an example of the complexity of the statute. It provides, among other things, that "A property owner or owner's agent or lessee who causes the removal of a vehicle parked on that property pursuant to the exemption set forth in subparagraph (A) of paragraph (1) of subdivision (l) and fails to comply with that subdivision is guilty of an infraction, punishable by a fine of one thousand dollars ($1,000)." (Vehicle Code §22658(d))

[4] For a thoughtful and comprehensive discussion of these issues, see "Suspension of a Homeowner Association's Corporate Status" at: www.berding-weil.com/articles/suspension-of-hoa-corporate-status.php