First Quarter · 2017

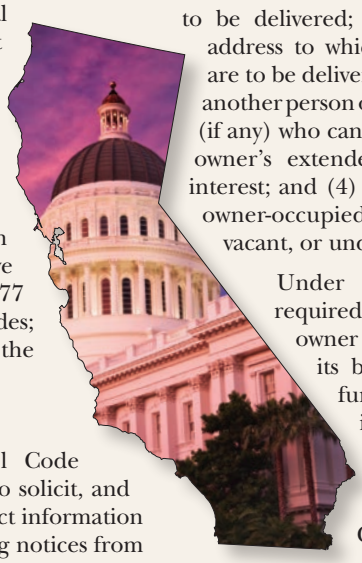
Kriger LAW FIRM News

In This Issue:

Impacts of 2017 California Legislation

By Bradley A. Schuber, Esq.

There were several new laws that went into effect this year. Among the more notable laws were Civil Code Section 4041 that requires owners to provide current contact information; Section 4775 concerning repair of exclusive use common area; Section 4777 regarding the application of pesticides; and Section 6000 which extended the Calderon sunset provision.



Civil Code Section 4041

Starting January 1, 2017, Civil Code Section 4041 requires associations to solicit, and for owners to provide, written contact information annually for the purpose of receiving notices from the association. Specifically, owners are to provide the following information: (1) the address or addresses to which notices from the association are to be delivered; (2) an alternate or secondary address to which notices from the association are to be delivered; (3) the name and address of another person or the owner's legal representative (if any) who can be contacted in the event of the owner's extended absence from the separate interest; and (4) whether the owner's property is owner-occupied, rented out, developed but vacant, or undeveloped land.

Under the statute, an association is required to solicit these notices from each owner and enter the information into its books and records annually. It further provides that the association is to make the solicitation at least 30 days prior to making its required annual budget disclosure pursuant to Civil Code section 5300. Lastly, the

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Tips for Avoiding Fraud and Embezzlement

By Garrett Wait, Esq.

Homeowners associations rely heavily on ethical duties imposed on laypeople who are most often volunteers with little or no ethical training regarding financial matters. Like many people, these volunteers can be tempted or swayed with easy access to corporate funds. For that underlying reason, homeowners associations are often fertile ground for fraud or embezzlement.

There are stories of inappropriate financial behavior from all types of people involved in association business. From the board president who skims off the top, the vendor who takes money for projects that are not completed, or even the manager who embezzles funds, associations must be constantly guarding their financial information.

The seriousness of protecting the association's financial information cannot be overstated, as fraud and embezzlement can become a very serious criminal issue. A finding of fraud can lead to personal liability for board members because D&O (Directors and Officers) insurance does not cover intentional acts. Moreover, fraud and embezzlement are criminal activities which can lead to jail time for the perpetrators and severely hamper an association's ability to do business.

Associations do have certain tools at their disposal to counteract unethical or fraudulent behavior, however. An association's internal controls are the first line of defense against potential embezzlement by board members, employees, managers, agents, or other parties with access to association funds.

Board members are given broad authority to review financial records and supervise the financial dealings of the association. In fact, board members have a statutory duty under Civil Code § 5500 to review financial records on a quarterly basis. Elements of a good review process include a regular - but not predictable – schedule of reviews, ensuring that reviews are not always done by the same board member, and open and transparent reporting to the entire board of any significant issues.

Granting duties to different board members for different financial action is likely the most important internal control because it creates

an additional barrier against fraudulent behavior and gives an association a greater ability to pinpoint potential problems. For instance, the same board members should not be in charge of both approving and recording financial transactions of the Association. Moreover, checks should require two board member signatures, and neither of those board members should record the transaction. Further, those signatures should be on file with the association's banking institutions so that the bank can alert the association of any discrepancies in signatures on checks.

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Requests For Assistance Animals

By Joel Kriger, Esq.

The Fair Housing laws require that Associations make a reasonable accommodation (which is an exception to its rules) for a resident with a disability who claims the need for an assistance or emotional support animal. This issue confronts associations that have rules which would not allow the requested assistance animal in the community. For example, dogs up to 35 pounds are allowed but the owner requires a 50-pound Labrador as their emotional support-assistance animal. This article will discuss proposed regulations which may soon be adopted by the California Department of Fair of Employment and Housing creating standards for approval or denial of such requests.

There is a distinction between service animals and assistance animals. A dog will qualify as a service animal if it performs a specific task, such as retrieving dropped items, reminding individuals to take medicine, providing safety checks for individuals with post-traumatic stress disorder, and interfering to stop damaging behavior. Associations do not generally have any issue with service animals as there is clear documentation of their training and status. In contrast, the benefit of an emotional support animal comes not from its performance of the task, but from the comfort provided by its mere presence. The assistance/emotional support animal has no special training and is indistinguishable from an ordinary pet.

The proposed regulations allow the Association to require documentation from a qualified healthcare provider verifying the disability and the need for the assistance animal to afford the person an equal opportunity to use and enjoy their dwelling or common areas. The proof of disability must identify the specific species of animal needed and how the animal is necessary to afford the individual an equal opportunity to use and enjoy the property.

There are online services providing verification documentation for persons with emotional support animals. It is unlikely that these services meet the requirements of the regulations as the verification must be provided by a qualified healthcare provider which includes a medical doctor who treats the individual, a marriage and family therapist, other healthcare professionals including, dentists, chiropractors, nurse practitioners, etc. A non-medical service agency, social worker or a reliable third-party who is in a position to know about the individual's disability and the necessity of the requested accommodation also qualifies. ■

Homeowners Association Awarded Attorneys' Fees Even Though Court Ruled Most Fines Disallowed

By Jamie Handrick, Esq.

In *Almanor Lakeside Villas Owners Association v. Carson,* the California Court of Appeal upheld a substantial attorneys' fees award to the homeowners association as prevailing party in a lawsuit to collect fines against owners for violations of the Association's governing documents.

James and Kimberly Carson owned a lodge and chalet located within Almanor Lakeside Villas Owners Association. Very few lots within the Association were allowed to be used commercially. According to the CC&Rs, all other lots were for residential use only but the Carsons used their lots as short term vacation rentals. The Carsons' lodge existed before the Association was formed, but the CC&Rs applied to the Carsons' lots.

One section of the CC&Rs said the properties could be used for commercial or residential purposes. Another section of the CC&Rs prohibited using lots for transient or hotel purposes, or renting for fewer than 30 days. The Board created rules enforcing the 30-day lease limitation. Rules were added exempting commercial lots from the minimum lease term. Other rules included regulation of community boat slips, common areas and parking. The Board fined the Carsons for a variety of violations. The Carsons disputed the fines and believed the short-term rental restrictions did not apply to them since the lodge was operated as a vacation lodge for many years. The Carsons also failed to pay assessments for about two years. They tried to bring their assessment account current by making a payment of $14,000 toward delinquent assessments.

The message here is even if the Association does not prevail on all aspects of its case, as long as it prevails on some of the issues, it can be awarded reasonable attorneys' fees and costs.

The Association sued the Carsons for about $54,000 in assessments, fines, fees, and interest. The Carsons disputed the fines stating the rules were unlawful restrictions on their commercially-zoned lots. The trial court recognized the conflict in the CC&Rs but ruled the Association could still restrict how the properties were used, as long as the restrictions were reasonable and consistent with commercial lodging use. The trial court upheld only a portion of the fines, late charges and interest. Both sides requested an award of attorneys' fees under the Davis-Stirling Act. The trial court decided that the Association was the prevailing party and awarded $101,803 in attorneys' fees and costs.

The Court of Appeal determined that even though the trial court did not believe all of the Association's restrictions were enforceable, the trial court confirmed the Association's authority to adopt and enforce reasonable rules. Even though 90% of the fines were disallowed, that did not overturn the effect of the trial court's ruling. The Court of Appeal upheld the trial court's ruling on attorneys' fees. The message here is even if the Association does not prevail on all aspects of its case, as long as it prevails on some of the issues, it can be awarded reasonable attorneys' fees and costs. ■

Watch Out for Abuse of the Power of Attorney

By Garrett Wait, Esq.

Powers of attorney grant third parties the ability to conduct business on behalf of a granting party. In the context of homeowners associations, powers of attorney can be misused by third parties in an attempt to gain influence over an association. Fraudulent use of a power of attorney is a serious risk for which homeowners associations should be on the lookout.

Powers of attorney are a minefield for homeowners associations because they are so directly tied to the trustworthiness of the person holding the power of attorney.

Recently, a client of ours had an issue wherein an investor bought more than 15 properties within a single community with the intention of controlling the association's board of directors. The method the investor chose to pursue this course of action was through a power of attorney, vested in three different property managers for all of the manager's properties. Two of the property managers attempted to run for the board of directors via this power of attorney, but was denied by the Association's bylaws which only allowed owners to run for the board of directors. The investor was upset, as expected, but the Association likely dodged a bullet by having that provision in its bylaws.

The most common power of attorney seen in most homeowners associations is a proxy. A proxy acts as a limited power of attorney solely for the purpose of allowing the proxyholder to vote on behalf of a member. Thankfully the Davis-Stirling Act places a restriction on the use of proxies through Civil Code section 5130, which only allows other members of the Association to be used as proxies. This limits the influence of outside third parties, but proxies may still be an issue in homeowners associations because of the consolidation of voting power inherent in proxy voting.

One of the biggest problems with proxies is election fraud that occurs if the proxyholder deigns to change the vote of the member on whose behalf they are voting. This type of election fraud is nearly impossible to prove because the proxygiver's instructions are kept secret on a separate page seen only by the proxyholder. Nobody will know if the proxyholder decides to vote against the instructions of the proxygiver. We often recommend that associations remove proxy language when restating bylaws in order to avoid the issues that can arise out of the use of proxies. Of course, the downside to that is the risk that an association will have a more difficult time reaching quorum during elections due to member apathy.

Powers of attorney are a minefield for homeowners associations because they are so directly tied to the trustworthiness of the person holding the power of attorney. Homeowners who wish to give someone a power of attorney – including a proxy for voting purposes – must be careful. More importantly, associations should safeguard against the abuse of these powers of attorney by strictly limiting their use in the governing documents.

Garrett Wait is an associate attorney at the Kriger Law Firm, APC, community association attorneys in La Mesa, California. ■

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TIPS FOR AVOIDING FRAUD AND EMBEZZLEMENT

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For associations with audit requirements in the governing documents, communicating effectively with the association's CPA during audits is an important safeguard against fraudulent behavior. Having a board liaison that can effectively explain the accountant's findings to the board of directors would only make things easier.

Of course, none of these internal controls are of any use if board members are not willing to instate such controls. To that end, management and association counsel should assist in setting a tone of transparency. Urging boards to adopt ethics policies for board members, and even going so far as to amend the bylaws to disqualify those who are unwilling to sign an ethics pledge, have been successful in solidifying the fiduciary duties that come with serving on a board of directors.

For their part, managers should be actively engaged with associations regarding their finances, and should be familiar with each association's internal controls. Professional managers are often the people in the best position to find and report any issues with the association's finances. Management can and should assist the board of directors in choosing an appropriate accounting professional for audits and financial reviews.

Managers should only recommend reputable vendors and contractors, and should help to ensure association vendors are paid appropriately for work completed. Still, boards should do their own due diligence in their vendor relationships by reviewing vendor contracts independently and by speaking with vendor representatives directly if necessary. Boards should frequently check projects done by contractors, especially those with plenty of change orders.

Most importantly, board members and managers should be proactive in protecting their association against fraud and embezzlement. Those types of white collar crimes can be committed quickly and misappropriation of funds can cripple an association. Redundancy cures temptation, and avoiding temptation is what protects associations in the long run. ■

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Corporate Office
8220 University Avenue, Suite 100
La Mesa, CA 91942-3837
(619) 589-8800 · FAX (619) 589-2680

Servicing San Diego, Riverside,
San Bernardino and Los Angeles Counties

krigerlawfirm.com

email: hoalaw@krigerlawfirm.com

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Managing Editor
Joel M. Kriger, Esq.

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statute provides that in the event an owner fails to provide a primary address and/or secondary address, then the property address will be deemed to be the correct address to which notices are to be delivered.

Civil Code Section 4775

Another law that went into effect this year is Civil Code Section 4775 (prior Civil Code Section 1364). The statute sets forth maintenance responsibilities and changes repair responsibilities for exclusive use common areas. It provides that unless otherwise provided in the declaration of a common interest development, the owner of a separate interest is responsible for maintaining exclusive use common area and the association is responsible for repairing and replacing exclusive use common area.

Previously owners were responsible for repair of exclusive use common areas. Although Civil Code Section 4775 went into effect this year, the bill was originally passed in 2014. The idea behind the delay in the effective date was to provide associations with an opportunity to adapt to the change in law. As provided in the statute, associations can amend their CC&Rs to shift responsibility for repairing exclusive use common area back to the individual owners.

Civil Code Section 4777

Another law that went into effect this year is Civil Code Section 4777. According to the statute, an association that applies a pesticide to a separate interest or to the common area without a licensed pest control operator shall provide written notice to the owner and, if applicable, the tenant of an affected separate interest. Similarly an association that makes broadcast applications (an area greater than 2 square feet), or uses total release foggers or aerosol sprays, shall provide written notice to the owner and, if applicable, the tenant in an adjacent separate interest that could reasonably be impacted by the pesticide.

According to the statute, the notice must use words with common and every day meaning and provide the following information: (1) the pest(s) to be controlled; (2) the name and brand of the pesticide product to be used; (3) the approximate date, time, and frequency with which the pesticide will be applied; (4) a notification that "The approximate date, time and frequency of this pesticide application is subject to change"; and (5) specific statutory language to be copied directly into the notice providing health, safety and regulatory information.

When applying the pesticide, the statute generally requires the Association to provide at least forty eight (48) hours prior written notice, except in emergency situations, then the association can simply post the notice as soon as practicable, but not later than one hour after the pesticide is applied. In all circumstances, an association must attach a copy of the notice to the minutes of the board meeting immediately following the application of the pesticide.

Civil Code Section 6000

Lastly, an amendment to Civil Code Section 6000 went into effect his year. Civil Code Section 6000, also known as the Calderon statute, sets forth specific pre-litigation requirements applicable to homeowner associations alleging construction defect claims against builders, developers and general contractors of common interest developments.

The amendment simply extends a sunset provision built into the statute. Previously, the statute was set to become inoperative as of July 1, 2017; however, with the passing of the amendment the statute is now extended and will automatically become inoperative on July 1, 2024, absent a future amendment. ■