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# Current Condominium Practice Problems

JOHN PAUL HANNA\*

The emergence of the condominium as a viable urban housing alternative has created certain recurrent legal problems for the practitioner. This article proposes to analyze some of the more common problems associated with condominiums, including problems facing the developers of such projects, the owners of individual units and the owners' associations for such projects; it will also attempt to provide some practical avenues of approach to these problems.

## I. CONDOMINIUM OPERATIONS

### A. ENFORCEMENT OF RESTRICTIONS.

Almost all condominium declarations contain the same provisions which purport to give the association or any owner of a condominium unit in the project the right to enforce all restrictions, conditions and covenants imposed by the declaration.<sup>1</sup> Typically, such declarations<sup>2</sup> provide that the board of directors of the association are empowered to enforce the restrictions and to penalize violations of restrictions, by such means as suspension of voting privileges,

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1. CAL. CIV. CODE § 1355 (West Supp. 1976) provides statutory authority for this procedure. See also J. HANNA, CALIFORNIA CONDOMINIUM HANDBOOK § 136 (1975) [hereinafter cited as CONDOMINIUM HANDBOOK].

2. CONDOMINIUM HANDBOOK § 248, Art. IV, para. 10.

withholding of privileges for use of recreational facilities and imposition of fines. Some interesting situations arise in this context, often posing problems both for the lawyer representing the association and for the lawyer representing the individual condominium unit owner.

For example, in a typical thirty unit condominium project consisting of a three-story building constructed around a centrally located pool and courtyard, the use of the pool becomes of crucial importance to all thirty owners. The location of the pool makes it the focus of all social and recreational activity within the development. Since all unit owners will be affected directly or indirectly by what goes on in and around the pool, the rules and regulations established for the use of the pool and the enforcement of those rules and regulations will have a significant, direct effect upon the quality of life within the project.

The typical declaration will not spell out in great detail all the rules for the use of the pool, but will authorize the board of directors to adopt rules and regulations from time to time designed to restrict and control activities in and around the pool area for the mutual benefit of all owners. In a sense this can be termed a form of land use control at the lowest level. The board of directors is acting as a quasi-governmental body in establishing and enforcing rules.

Suppose that one family is "out of step" with the rest of the unit owners. For whatever reason this owner is devoid of such qualities as good manners, basic decency, and respect for the rights of others and has communicated his anti-social attitude to the other members of his family so that the entire group is a threat to the peace and quiet of the project. Suppose further that the board of directors started with some very simple house rules pertaining to the use of the pool. The rules provided that there would be no swimming in the pool by children under fourteen (14) years of age without an adult supervisor present and that the pool could not be used after ten o'clock at night or before six o'clock in the morning. Assume that the board met to consider and adopt additional rules the first week after the disgruntled owner moved in with his wife and four boys. These rules prohibit the consumption of food and beverages at pool side, running or horseplay in the pool area and loud noise or profanity in the pool area at any time. Such rules

were adopted in accordance with the requirements of the declaration and by-laws, and were posted in the pool area and delivered to all the members.

By the end of the following week every one of the rules had been violated by the family. The first action taken by the board was to write a letter of reprimand. The letter politely referred to the rules and suggested that the conduct of the family was particularly disturbing to a substantial number of the other unit owners and asked that the rules be observed. The letter was ignored. The board then met again and passed a resolution censuring the conduct of the family, indicating that any further violation of the rules would result in a restriction of pool privileges. The resolution was duly entered, and a copy was personally delivered to the owner. It had no effect. The board met for a third time and passed a resolution revoking privileges to use the pool for thirty days. The adopted resolution was placed in the minutes of the meetings and a copy was mailed and personally delivered to the family. Immediately upon receipt of the notice the entire family put on their suits, marched to the pool and started their own version of water polo. Their conduct awakened one resident who was trying to sleep in his third floor apartment overlooking the pool, caused a mother who was trying to teach her five-year-old to swim to leave the pool, and forced an elderly couple who were sunning themselves by the edge of the pool to retire to the relative quiet of their unit.

The president of the association called an emergency meeting of the board of directors. A resolution was passed which suspended the voting privileges of the owner for thirty days, authorized the imposition of fine of one hundred dollars and suspended the right to use the pool facilities for a period of thirty days, with an automatic fine of one hundred dollars for every violation thereof. The resolution was incorporated in the minutes and a copy delivered personally and by mail to the owner.

Shortly thereafter, the president received a letter from an attorney. The letter stated that the attorney represented the family and that any attempt by the association to fine his clients, impose a lien upon their condominium unit or to otherwise deprive them of their constitutional and property rights would result in the immediate filing of an action for damages.

Although this may seem like a farfetched example, it is based upon actual facts. Furthermore, the facts here assumed do not represent a particularly unique or unusual situation. Such prob-

lems occur with increasing frequency as the number of people living in condominium projects grows.

What should the attorney for the association recommend when advised of such facts? Initially, the attorney should examine the declaration and the other project documents. He should then review the minutes of the meetings, resolutions and correspondence of the association. When he has satisfied himself that the association in fact has the power to promulgate rules and regulations, and that such rules and regulations have been passed in accordance with the procedures authorized by the condominium documents, he must evaluate the argument put forth by counsel for the non-conforming owner. There is little question that the association has both the power to make rules and regulations and the authority to enforce them, just as it has the power to make assessments and enforce them using lien procedures.<sup>3</sup> Thus the central issue is one of procedural due process: is the association or the board of directors required to hold a hearing before it can suspend privileges and impose fines on an owner?<sup>4</sup> Alternatively stated, is the owner entitled to notice of the hearing and an opportunity to appear and defend himself against the charges because of the analogy between association and governmental disciplinary activity?<sup>5</sup>

A noticed hearing could certainly be a minimum requirement if disciplinary action were being imposed by a governmental body or by a court. Recent regulations promulgated by the Real Estate Commissioner<sup>6</sup> indicate that project declarations should provide for notice and hearing prior to disciplinary proceedings. Courts will probably require that these procedures be followed in all but exceptional cases.

A second question involves the reasonableness of the action taken. If called upon to adjudicate this issue on the facts described above, a court could find that the action of the board was reasonable and, therefore, valid.<sup>7</sup> However, a slight change in the assumed facts

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3. CAL. CIV. CODE § 1355 (West Supp. 1976).

4. See, 10 CAL. ADMIN. CODE § 2792.26 (filed Jan. 18, 1976); KEEPING CONDOMINIUM DISPUTES OUT OF COURT, THE CONDOMINIUM REPORT Vol. 2, No. 2, p.6 (1974).

5. *Id.*

6. 10 CAL. ADMIN. CODE § 2792.26 (filed Jan. 18, 1976).

7. CAL. CIV. CODE § 1359 (West Supp. 1976) provides some ancillary

could produce a different result. The result should be different if the board of directors, without any advance notice or warning, held a special meeting during which it passed a resolution fining an owner for some past violation of the rules, and the owner vigorously disputed the allegation that he had violated the rules when he was subsequently notified that a lien had been filed against his property. In such a case notice of hearing would be required to protect the owner against the possibility of arbitrary and capricious action on the part of the board.

If a noticed hearing is conducted, the owner should be given a chance to answer the charges, to cross-examine the witnesses against him and to present his evidence.<sup>8</sup> If the function of the disciplinary hearing has been delegated to a committee, the rules should provide for an appeal from an adverse decision to the board of directors.<sup>9</sup>

Should litigation ensue, an owner would have several possible avenues of approach: declaratory relief, quiet title (to remove the lien), and for injunction (to obtain an order preventing interference with his right to use common area facilities or to stop a foreclosure sale). In such an action, a court would no doubt require a strong showing to upset action by the board of directors. Since the case would be similar to an action attacking the decision of a local governing body, there ought to exist a presumption in favor of the action taken by the board, when such action is in accordance with statutory and regulatory requirements.<sup>10</sup>

In the event that the board imposes a fine, the procedures for filing a lien are generally set forth in the declaration.<sup>11</sup> A notice of assessment must be recorded.<sup>12</sup> The board would have to enforce the lien within one year from the date of recordation of the notice unless the period were extended by recording a written extension.<sup>13</sup>

In the hypothetical case previously assumed, if the board were to impose a series of one hundred dollar fines over a period of thirty days (based upon the continued use of the pool facilities in violation of its rule) it could, if it chose, record each lien separately. Alter-

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support, for this section provides that any deed, declaration or plan for a condominium project shall be liberally construed to facilitate the operation of the project.

8. *Supra* note 4.

9. *Id.*

10. *Supra* notes 3 and 6.

11. CONDOMINIUM HANDBOOK § 136.

12. CAL. CIV. CODE § 1356 (West Supp. 1976).

13. *Id.*

natively, it could wait until the end of the thirty-day period, aggregate the fines, and file a single lien for the total amount.<sup>14</sup> For obvious reasons, it is preferable to have one lien and one foreclosure proceeding rather than multiple proceedings.<sup>15</sup>

#### B. AMENDMENT OF RESTRICTIONS.

Assume that our hypothetical family is the only owner having children. Assume further that the remaining owners decide to oust the family from the project by an amendment which will affect only this family. The declaration provides that the covenants, conditions and restrictions can be amended by a 75% vote of the membership.<sup>16</sup> Assume further that a membership meeting is duly noticed in accordance with the by-laws, that the notice contains the text of a proposed amendment to the use restrictions, and that such amendment provides that no children under eighteen years of age may be permanent residents of the project. At the meeting the resolution is passed, the declaration is amended and the amendment is recorded in the county.

What is the effect of such action upon the family? Can they be deprived of an important property right? Must they sell their interest in the condominium and move elsewhere? Can the majority of condominium owners, possessing a power to amend the covenants, conditions and restrictions, amend them in such a way as to deprive the minority of material vested property rights?

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14. *Id.*

15. Some authors have expressed doubt as to the ability of the association to use the lien method to enforce collection of fines. Lowell, Prah, Alessio, Cazares, *Land Use and Operational Controls in the Planned Development*, 9 SAN DIEGO L. REV. 28, 62 (1971). *But see* 10 CAL. ADMIN. CODE § 2792.26 (filed Jan. 18, 1976). One author has cast a pall over the foreclosure procedure, A. BOWMAN, *OGDEN'S REVISED CALIFORNIA REAL PROPERTY LAW* § 16.22 (1974). In discussing condominiums from the viewpoint of a title insurance company, Mr. Bowman states: "No insurance should be issued that names the right of a managing body to foreclose liens imposed in the declarations of restrictions."

16. *See*, CAL. CIV. CODE § 1355(c) (West Supp. 1976) which provides: "for amendments of such restrictions which amendments *if reasonable*, and made upon vote or consent of not less than a majority in interest of the owners of the project given after reasonable notice, shall be binding upon every owner and every condominium subject thereto . . ." (emphasis added). *CONDOMINIUM HANDBOOK* § 248, Art. VIII, para. 5.

Certainly the majority of unit owners has the right to amend restrictions and to make new restrictions in order to preserve, protect and even create a certain life style. It goes without saying that in so doing it must observe procedural due process requirements. But the question now is not one of procedure, but of substance: can an owner be deprived of his right to use his property by the majority?

One might argue that the majority has the right under the law and under its legal documents to establish the kind of community in which its members desire to live. Thus, age restrictions have been upheld.<sup>17</sup> However, does that theory extend to the type of exclusion just postulated?

A solution to this lies in the requirement of a grandfather clause. The assumed fact situation is analogous to the preservation of a nonconforming use after amendment of zoning ordinance. Those owners who have children under eighteen residing within the project on the date the restrictive amendment is recorded should be permitted to have their children continue that occupancy until the unit is sold. Similarly, a young couple who owns a unit should not be forced to sell that unit if the wife, who is pregnant when the amendment is passed gives birth shortly thereafter. A slightly more difficult question would arise in the case of a couple who conceive after the adoption and recordation of the restrictive amendment. Once the restrictive amendment is passed, the sale or lease of a unit to a family having children under eighteen who would reside on the premises should not be permitted.

#### C. INCORPORATED VS. UNINCORPORATED ASSOCIATIONS; PROS AND CONS.

The question of whether or not to incorporate the owners' association arises in two contexts: (1) the original developer is ordinarily faced with that decision; and (2) after control of the association is assumed by the condominium owners, they have an opportunity to reconsider that question. Obviously they may reach different conclusions on the advantages and disadvantages of incorporation.

The oversimplified answer to the question is that a large development should always have its owners' association incorporated while a very small development is better off being unincorporated. To begin with, the corporate form offers the obvious advan-

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17. CONDOMINIUM HANDBOOK § 92.



tage of centralized management. While theoretically members of an unincorporated association have more control over the governing body than the members of an incorporated association have over their board of directors, the advantage lies in favor of the corporate form.<sup>18</sup> While it is possible to duplicate all the centralized management advantages of the corporation by incorporating all provisions of corporate law pertaining to management in a set of by-laws for an unincorporated association, the result would be an extremely lengthy and perhaps unwieldy set of legal documents.<sup>19</sup>

Proxy voting is certainly an important part of the operation of an association. There may be some question about proxy voting in unincorporated associations.<sup>20</sup> Further, an incorporated association can act with greater certainty than an unincorporated association in the area of contracts. An unincorporated association must have a specific delegation of authority from the membership. A corporation, however, has statutory authority for the board to enter into contracts on behalf of the corporation.<sup>21</sup> Additionally, the limited liability of members of an incorporated condominium association is better established than the limited liability of members of an unincorporated association.<sup>22</sup>

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18. From a practical viewpoint close control of an association may be quite disadvantageous. Many members do not have the time or inclination to be involved with the day-to-day problems of association management. The more centralized form of association may facilitate routine operations.

19. *White v. Cox*, 17 Cal. App. 3d 824, 95 Cal. Rptr. 259 (1971) held that an unincorporated association may be a legal entity apart from its membership. However, the vast body of case law which serves as a guideline for corporate operations would generally be unavailable to an unincorporated association in evaluating its operations.

20. *Market Street Railway Company v. Hillman*, 109 Cal. 571, 42 P. 225 (1895); Jackson, *Non-Profit Homeowners' Association: Should They Incorporate?*, L.A.B. BULL. 509, 510 (1974).

21. CAL. CORP. CODE § 802 (West 1955). Further, if litigation should develop over a contract, the board of directors of a corporation may indemnify an officer, director or employee for expenses incurred in defending the suit. CAL. CORP. CODE § 830(f) (West Supp. 1976).

22. CONDOMINIUM HANDBOOK § 141. Liabilities of membership could be of two types: contractual and tortious. In contract, for example in a suit by a maintenance contractor against an unincorporated association, nothing seems to preclude the membership from being named as necessary parties. *White v. Cox*, 17 Cal. App. 3d 824, 95 Cal. Rptr. 259 (1971). However, with an incorporated association the membership would not generally be proper parties, *Friendly Village Community Association, Inc. v. Silva*

The factors enumerated above suggest that there are definite advantages to incorporation. The chief disadvantage of incorporation is the annual two hundred dollar franchise tax. The obvious benefits to be obtained from incorporation have caused some commentators to refer to the franchise tax as an inexpensive form of insurance.<sup>23</sup>

From an income tax standpoint, it does not seem to matter whether the association is incorporated or not since an unincorporated association will have corporate characteristics and will be treated as an association taxable as a corporation.<sup>24</sup> For federal income tax purposes, the condominium owners' association, is a separate taxable entity subject to corporate income tax whether incorporated or unincorporated but having corporate characteristics. Furthermore, the Internal Revenue Service has ruled that an exemption is not available to a condominium unit owners' association.<sup>25</sup> Assessments in excess of expenditures are income subject to tax unless such assessments must, under the by-laws, either be refunded to the members each year or applied to assessments for the following year.<sup>26</sup> Contributions towards capital improvement reserves which are neither refundable nor applied against the following year's assessments are not taxable if they are earmarked for specific capital improvements.<sup>27</sup>

## II. CONDOMINIUM DEVELOPERS.

### A. PHASED PROJECTS.<sup>28</sup>

In a large condominium project that is ultimately going to contain 800 units, there are certain advantages to having an integrated

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& Hill Construction Company, 31 Cal. App. 3d 220, 107 Cal. Rptr. 123 (1973). Vicarious tort liability is still a risk to members of an unincorporated association and the exposure could be great. CAL. CORP. CODE §§ 24000 *et seq.* (West Supp. 1976).

The extent to which the membership may be individually liable for a judgment against the association may depend on the form of the association. In *White v. Cox*, 17 Cal. App. 3d 824, 95 Cal. Rptr. 259 (1971), the court held that the individual members need not be named in an action against the unincorporated association but could be sued separately. The court did not define the property from which the plaintiff could satisfy his judgment or the extent to which individual members could be liable to one another for tortious conduct.

23. Jackson, *Non-Profit Homeowners' Association: Should They Incorporate?*, 49 L.A.B. BULL. 509, 534 (1974).

24. CAL. REV. & TAX. CODE § 23038 (West Supp. 1976); INT. REV. CODE OF 1954, § 7701(a) (3).

25. REV. RUL. 74-17, 1974-1 CUM. BULL. 131.

26. REV. RUL. 70-604, 1970-2 CUM. BULL. 9.

27. REV. RUL. 74-563, 1974-2 CUM. BULL. 38; *Lake Petersburg Association v. Commissioner*, 33 TCM 259 (1974); CONDOMINIUM HANDBOOK § 208.

28. See, 10 CAL. ADMIN. CODE § 2792.27.

development with a single condominium owners' association. The single association approach provides a strong financial base to spread major costs over the total number of units. Having a single entity also avoids a multiplicity of legal entities involved in the administration of a number of different units of the project. Legal and accounting expenses are greatly diminished and the extent of administrative problems lessened if a single association is involved.

However, certain economic factors work against use of a single association and usually result in the creation of several smaller communities within the larger community. The most significant factors are the requirements imposed by lenders and by the Department of Real Estate.

The construction lender or the take-out lender may require that 51% or more of the units in a project be sold before any units will be released from the loan. That requirement alone will probably cause a developer to divide the 800-unit project into at least eight separate phases. The Department of Real Estate requires that a developer commit to building the entire 800 units if he is advertising the sale of condominiums based on the representation that there will be an 800-unit development with appropriate recreational facilities.<sup>29</sup> The department will also require the developer to pay assessments on the unsold units.<sup>30</sup> This can cause a crushing economic burden if the developer has sold only 100 units and has to pay assessments on the remainder.

The technique of a phased development has been developed as the answer to these problems. The object of this technique is to set up the mechanics of different phases so that the entire development can be tied together even though it is done in eight or more separate phases. One method is to put all the recreational facilities and open space areas into a single parcel of land and convey title to an umbrella homeowners' association which has capacity to expand membership as each phase comes into being through recordation of a declaration of annexation. Eventually the umbrella association will consist of all 800 members; it will own everything

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29. 10 CAL. ADMIN. CODE § 2799.1.

30. 10 CAL. ADMIN. CODE § 2792.9.

except the condominium units themselves and the buildings in which the condominium units are located.

If the developer elects to convey title to the entire open space common area to the association with the development of the first phase, he is then committed to complete the entire development. From the operational standpoint this method is simplest because a single umbrella association results, which association owns the entire common area except for the air space units and the buildings themselves. That association collects all the assessments and handles all of the maintenance of the entire project.

If the developer does not wish to commit himself to complete the entire project until he knows how sales will go, he can divide the project into eight separate phases, each phase containing its own open space common area. The unit owner in each phase will receive title to his air space unit and an undivided 1/100th interest in the land within phase I, including the building constructed thereon. Under this technique, there are eight separate condominium owners' associations, each handling the maintenance of its own area. The declarant reserves easements for ingress and egress to the eight separate common open space areas (exclusive of the buildings constructed thereon). As each subsequent phase is annexed the declarant grants those easements to that phase and at the same time grants reciprocal easements to the prior existing phases. During this process the developer must be mindful of the budget at all times. The Department of Real Estate<sup>31</sup> will require a detailed budget for a phased project which will show the proposed assessments at each stage of the development. This all has to be worked out and forecast in advance.<sup>32</sup>

Another technique to reduce assessment costs during the construction stage is to reduce the budget to the actual expenses involved during the development phase (which will generally be less than the expenses after all units have been sold) and then divide equally that smaller amount among the total units including those owned by the developer. This will generally result in a lower assessment per unit during the "startup" phase than the assessment ultimately provided for in the budget for the completed project.

#### B. ADVERTISING—CONDOMINIUM VS. PLANNED UNIT DEVELOPMENT.

Can the developer of a planned unit development advertise it in

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31. 10 CAL. ADMIN. CODE § 2792.6.

32. CONDOMINIUM HANDBOOK § 248, Art. IV.

the newspaper as a "condominium?"<sup>33</sup> The Department of Real Estate<sup>34</sup> takes the position that if the project as structured is clearly a planned unit development and not a condominium, advertising it as a condominium would be misleading and the developer can be required to desist and refrain from such advertising.

C. OFFICE CONDOMINIUMS: ALTERNATIVE METHOD OF DESCRIBING SPACE.

The standard method of selling condominiums is to sell units of predetermined size and space with the horizontal boundaries being the walls and the vertical boundaries being the floors and ceilings. This approach does not lend itself well to the sale of office space; office space users do not buy two bedroom one bath units or three bedroom two bath units, etc. Rather, they deal in square footage. This problem is easily solved when one looks at the condominium as if it were simply a three-dimensional subdivision. Subdivision can be divided into as many different sizes and shapes as zoning will allow. There are no size or shape requirements that limit the three-dimensional division of condominium airspace. The developer can have his engineer draw imaginary grid lines on the condominium diagram, dividing each floor of the office building into airspace modules. The developer can then sell airspace modules on a flexible basis to each purchaser. The developer can put in common wall partitions and the purchaser can take care of his own interior partitions.<sup>35</sup>

D. FINANCING: THE EFFECT OF GOVERNMENTAL REQUIREMENTS FOR MORTGAGE PROTECTION CLAUSE ON THE OPERATION OF CONDOMINIUM ASSOCIATIONS.

During periods of tight money, banks and savings and loan institutions require increased access to the secondary mortgage market. At such times, developers run into the requirements of FNMA<sup>36</sup> and FHLMC.<sup>37</sup> If condominium documents are not drafted in the first instance to meet the requirements of those institutions,

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33. CAL. BUS. & PROF. CODE §§ 11003 and 11003.1 (West Supp. 1976).

34. 10 CAL. ADMIN. CODE § 2799.1.

35. CONDOMINIUM HANDBOOK § 7.

36. Federal National Mortgage Association.

37. Federal Home Loan Mortgage Corporation.

the lender may not be able to transfer the loan out of its portfolio. It may be too late for the developer to amend the declaration because some of the units may have already been sold. Without the ability to meet the FNMA and FHLMC requirements, sales may be slowed because of the difficulty in obtaining permanent loans. Developers not having a present need for FNMA or FHLMC financing may "play it safe" and insert provisions in the condominium legal documents which will meet the requirements of those institutions. In electing this course of action, developers have to balance the advantage of access to the secondary mortgage market in the future against the disadvantage of some cumbersome administrative and procedural problems created by the required provisions.

Notification of trustees in the event of default by any owner in his obligations is not too difficult or too cumbersome a requirement. Most of the other requirements are not burdensome either.<sup>38</sup> The only one that is likely to give real trouble is the requirement for approval by lenders of any proposed change in the condominium legal documents. A typical provision requires 75% to 100% of institutional lenders to approve any material change in the provisions of the condominium documents. Such a provision can severely hamper, if not entirely frustrate, the desire of owners to amend condominium documents. The Department of Real Estate at one time objected to this unwarranted interference with the internal administrative affairs of condominium projects by governmental and quasi-governmental lending institutions, but apparently the department was not able to persuade the institutions to delete these requirements. The practical result is that a condominium which has such provisions in its documents must maintain a current roster of lenders and must notify them any time it wishes to change the declaration, articles or by-laws.

### III. CONDOMINIUM OWNERS.

#### A. INSURANCE.

When condominiums first became popular, insurance companies were caught unprepared. As a result many condominium purchasers bought homeowners', landlords' or tenants' policies when they should have obtained condominium unit owners' coverage.

Today there is little difficulty in obtaining a proper policy from an experienced broker. The condominium association should carry a master policy which includes all of the common area of the con-

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38. CONDOMINIUM HANDBOOK § 46.

dominium project. In California this is known as a "special multi-peril (SMP) condominium general property form." The most recent available form is multi-line bureau (MLB)-29, 1974 edition. The property covered includes buildings and personal property owned in common, but excludes individual condominium units or the property located therein. The coverage is similar to the coverage provided in a homeowner's policy or a landlord's policy. Losses are made payable to an insurance trustee designated by the association. Many different endorsements and deductible provisions are available. Special endorsements include coverage for replacement fixtures, various deductible amounts, glass coverage, boiler and machinery coverage, trees, plants, shrubs, interior rain damage and other things. The association also needs primary liability insurance protection which is provided by MLB-200. Each unit owner becomes an insured under the liability section for portions of the condominium premises which are not for the exclusive use or occupancy of the unit owner. The SMP policy has a waiver of subrogation which applies both to property and liability as to individual unit owners. A cross-liability endorsement will provide coverage when one unit owner sues the association or another unit owner for damages resulting from an accident occurring in the common area by reason of the negligence of either the association or another unit owner.

The condominium unit owner must also purchase a personal policy covering that portion of the condominium unit in which he has sole ownership, including storage areas, balconies, garage space, additions and alterations within his own unit, and his personal property and fixtures. The form presently available in California is condominium unit owners' form HO-6 together with condominium unit owners' multipurpose endorsement HO-CO. The basic policy provides coverage for damage to the owner's unit. Supplementary coverage includes coverage for additions and alterations to the interior of the unit. The multipurpose endorsement includes such things as loss of rental, apartment structures, assessments and additional living expenses. The policy also includes personal liability and medical payments.

Insurance coverage problems which develop after condominium units are sold include insufficient coverage because of gaps, overlapping coverage and wasting of premium dollars and conflict be-

tween policies with resulting loss adjustment complications. The simple solution to most of these problems is to involve only a single insurance company. However, it is not feasible to require that unit owners place their policies with the carrier issuing the master policy to the association.<sup>39</sup> It also may be impractical because of the varying life styles and insurance needs of the owners of different units. The best way to avoid problems is to promote adequate communication between the board of directors, the insurance carriers and the unit owners. All unit owners should file copies of their policies with the board. In a large condominium, an insurance committee should probably be appointed to review all unit owner's policies together with the master policy to alert themselves to overlapping coverage or inconsistencies in coverage. Three areas in which problems typically arise involve the co-insurance clause, the "no other insurance" clause and the subrogation clause.

Co-insurance comes into effect if the policy requires the property to be insured to a certain percentage (80%) of its replacement value; if this requirement is not met the insured becomes a co-insurer for the loss. This could become a problem in a condominium development if expensive interior improvements are made to various units and the owners do not increase their insurance to cover them.

The "no other insurance" clause contained in most policies might be a problem where the master policy contains such a provision and a policy with overlapping coverage is taken out by a unit owner which is construed to be "other insurance." Despite some commentators<sup>40</sup> who assert that in such cases the second policy might be void, the preferable result would seem to be that as long as the hazard has not been increased, coverage under both policies should be in effect notwithstanding the provisions.<sup>41</sup>

Subrogation rights come into play where one owner sues the association and under the master policy the insurance company is subrogated to the rights of the association against another negligent owner. Unless the subrogation clause is waived there would be little point in having a master liability policy covering damage claims by members of the association. Both the declaration and the master policy should refer to the waiver of subrogation by the carrier.

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39. CONDOMINIUM HANDBOOK § 117.

40. 5 APPLEMAN, INSURANCE LAW AND PRACTICE § 3066 (1970); 9 COUCH ON INSURANCE §§ 37:1397-98 (2d ed. 1962).

41. See, *American Insurance Co. v. Kelley*, 160 Tex. 71, 325 S.W.2d 370 (1959).



### B. COMPATIVE NEGLIGENCE: THE EFFECT OF COMPARATIVE NEGLIGENCE DOCTRINE ON LIABILITY OF OWNERS

The California Supreme Court, in *Li v. Yellow Cab Company*,<sup>42</sup> has abolished the defense of contributory negligence as a bar to recovery in California. A "pure form"<sup>43</sup> of comparative negligence has been substituted in its place. The effect of the *Li* decision upon the tort liability of owners' associations is open to question at this time.

In *Orser v. Vierra*,<sup>44</sup> the court held that vicarious liability of one member of an unincorporated association may exist because of the acts of other members if there is personal participation by or setting in motion of events by the person charged. In *White v. Cox*,<sup>45</sup> the court held that a member of an unincorporated condominium association may sue the association in tort. The question of the right of a member to sue association members in tort for damages arising out of an injury occurring in the common area was left open. Some other questions still undecided include the manner in which damages should be apportioned among joint tort-feasors under the pure comparative negligence doctrine and the right of contribution among such tort-feasors. Hopefully, all doubts will be resolved in favor of apportionment among joint tort-feasors in accordance with the percentage of negligence or fault attributable to each of them with each joint tort-feasor liable only for his percentage share of the damages or, in the alternative, with each joint tort-feasor having the right of contribution from other joint tort-feasors in accordance with their respective percentages of negligence.<sup>46</sup>

In *White v. Cox*,<sup>47</sup> the plaintiff, who was a member of a condominium association, sued the association for personal injuries allegedly suffered when he tripped and fell over a water sprinkler

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42. 13 Cal. 3d 804, 532 P.2d 1226 (1975), 119 Cal. Rptr. 853.

43. Pure comparative negligence allows the plaintiff recovery regardless of the degree of his fault. In contrast, modified comparative negligence denies recovery to the plaintiff when his degree of fault exceeds 50 per cent. The doctrine might be better referred to as damage apportionment or comparative damages.

44. 252 Cal. App. 2d 660, 60 Cal. Rptr. 708 (1967).

45. 17 Cal. App. 3d 824, 95 Cal. Rptr. 259 (1971).

46. See generally V. SCHWARTZ, *COMPARATIVE NEGLIGENCE* (1974) and the special California Supplement (1975) thereto.

47. 252 Cal. App. 2d 660, 60 Cal. Rptr. 708 (1967).

negligently maintained by the association in the common area of the project. Prior to the decision in *Li v. Yellow Cab Company*,<sup>48</sup> contributory negligence on the part of the plaintiff would have barred his recovery. After *Li*,<sup>49</sup> his negligence, if any, will simply reduce his recovery in proportion to the amount of negligence attributable to him. His negligence might consist of his own carelessness in tripping over a sprinkler in plain view or it might consist of his participation to some degree in the action of the board which caused the sprinkler to be located at that place. In *White v. Cox*,<sup>50</sup> the court specifically found that the plaintiff was not a member of the board and that he had no effective control over the operation of the common area. A change in those facts could easily make him guilty of some contributory negligence which would invoke the comparative negligence rule set forth in *Li v. Yellow Cab*.<sup>51</sup>

If a case arises similar to *White v. Cox*,<sup>52</sup> but with contributory negligence on the part of the injured owner, plus another owner being named as a defendant in addition to the association, an interesting problem involving apportionment of damages and contribution among joint tort-feasors will be presented. If a single insurance company is involved, the problem of settlement or payment of a judgment would be greatly simplified. If the association and the defendant member who was held liable have separate policies, then the two companies must necessarily jointly resolve the question of payment. If the association has a policy but the defendant owner has no coverage, then it must be decided whether the injured plaintiff can recover the total amount to which he is entitled from the association (through its carrier) or whether he can only recover the portion of his damages for which the association was found responsible under the comparative negligence formula. If the negligence of an uninsured owner is imputed to the association, the question becomes academic since the injured plaintiff could collect the entire amount to which he is entitled from the association. In such event waiver of the subrogation clause in the policy should halt the proceedings.

#### IV. GOVERNMENT ENTITIES: REGULATION OF CONDOMINIUMS.

##### A. LOW-MODERATE INCOME HOUSING PLANS:

Many cities have recently included a low-moderate income hous-

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48. *Supra*, note 42.

49. *Id.*

50. 252 Cal. App. 2d 660, 60 Cal. Rptr. 708 (1967).

51. *Supra*, note 42.

52. 252 Cal. App. 2d 660, 60 Cal. Rptr. 708 (1967).

ing element in their general plan.<sup>53</sup> Based on the theory that it is appropriate for a local government to insure that low to moderate income families can afford housing, cities have devised various methods of artificially creating below-market-cost housing. Various methods have been devised for accomplishing this goal without the necessity of a tax-supported subsidy. One manner in which this has been accomplished occurs when the city grants higher density to the developer in return for the developer's agreement to sell some housing units at less than market value. Where the developer agrees to the arrangement in arms length bargaining, there is no problem of overreaching on the part of the city. However, in an area where the developer does not require anything from the city except approval of a tentative map or condominium plan which fully conforms to all the zoning and subdivision laws, the assertion by the city of its authority over such a project by requiring the developer to sell units at below market cost in return for approval of his map raises interesting questions. Cities justify this use of their authority on the grounds that the city's general plan must make adequate provision for the housing needs of all economic segments of the community.<sup>54</sup> There is little doubt a city possesses the power to pass an ordinance that makes provision for low-moderate income housing within a community. However, when the practical effect of the ordinance requires a developer to sell units at a loss, constitutional questions are raised.<sup>55</sup>

A typical ordinance might provide that in all condominium or apartment projects containing more than 20 units, at least twenty percent of the units shall be sold or leased at below market rates.<sup>56</sup> Faced with the problem of drafting such an ordinance or of attacking it, one first must consider the constitutional guarantees of due process, equal protection of the law and just compensation for

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53. See, CAL. GOV'T CODE § 65302 (West Supp. 1976).

54. *Id.*

55. See generally Kleven, *Inclusionary Ordinances—Policy and Legal Issues in Requiring Private Developers to Build Low Cost Housing*, 21 U.C.L.A. L. REV. 1432 (1974) [hereinafter cited as KLEVEN].

56. See, PALO ALTO, CAL. RESOLUTION NO. 4725, April 2, 1973, declaring the city's policy "new multiple housing developments involving twenty (20) or more units should include twenty percent (20%) to forty percent (40%) low/moderate income units, depending upon the size or type of the housing." Palo Alto is presently exploring methods to incorporate this policy statement into an ordinance.

deprivation of property.<sup>57</sup> One might argue that no deprivation of property occurs because the builder-developer may pass the cost along to the buyers of the other eighty percent of the units in the project and they, rather than the developer, will be the ones to subsidize the low cost unit buyers. That, however, is begging the question. In the past, in order for such an ordinance to be upheld an adequate showing of necessity was required to be made justifying such a use of the police power. Certainly the power of a city to impose conditions upon approval of the tentative condominium map is considerable. Until recently, however, the denial of the condominium map, in order to be supportable, would have to have been based upon a proper exercise of the police power and the ground for denial would have to have been reasonably related to the purposes of the condominium project itself.<sup>58</sup> It now appears that we have moved away from that position.

Under a plan of this sort, who actually pays the subsidy?<sup>59</sup> Certainly in the first instance the builder-developer pays the subsidy and takes the loss. The argument that he can pass it along to buyers of the other units may not be true in actuality. The developer is in competition with other builder-developers and if his units are over-priced they simply will not sell.<sup>60</sup> The city might argue that his competition will come from other large projects, subject to the same requirements. However, the typical buyer does not restrict his search for living quarters to one particular city. The builder-developer may be in competition with an equally attractive and lower priced development only a few blocks away in another city that does not have such an ordinance. The builder-developer must also compete with smaller projects located within the same city that are not subject to the ordinance. The first project subjected to such a requirement to this author's knowledge (ten percent of the units to be sold at below market) went into foreclosure and was taken over by a bank.<sup>61</sup> The city subsequently agreed to an increase in the sales price of the below market units, but the increase still did not bring the sales price to the fair market value.

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57. See, KLEVEN at 1490.

58. CONDOMINIUM HANDBOOK §§ 50, 52.

59. See, KLEVEN at 1493, concerning the economic impact of inclusionary ordinances.

60. *Id.* at 1524, concerning ensuring a reasonable rate of return.

61. Undoubtedly other factors were also involved. However, in planning an inclusionary zoning policy, consideration must be given to the economic impacts of such a policy with the realization that many projects are built with shoe-string financing or narrow profit margins.

There are ways to accomplish the objective of providing low priced housing, but there are many practical problems involved. One city that has adopted a low-moderate income element as part of its general plan desires to preserve the anonymity of the purchasers of the low-moderate income units. This is most difficult to do in a 30-unit project where two or three of the units are to be sold at a below market cost.

It is also important to insure that neither the buyer of a low cost unit or his heirs or successors get a windfall by being able to realize proceeds from a market sale of the unit at a later date. If the provisions restricting resale of the unit are not binding on lenders, the buyer of a low cost unit could refinance it, get a loan in excess of the purchase price of the property and then allow the bank to take over the unit upon foreclosure. The only way to prevent this is to make the restrictions on sale binding on lenders or those who acquire title as a result of foreclosure. In some cases this would no doubt restrict the marketability of those units.

Similarly, it is important to be sure that the buyer of such a unit does not secure windfall profits in the event of condemnation, destruction of the unit by fire followed by payment of insurance proceeds to the owners rather than reconstructing the project or upon termination of the condominium regime and sale of the entire project for rental housing. Anyone drafting an ordinance to place restrictions upon the sale of housing under a low-moderate income housing plan must keep one eye on the rule against perpetuities<sup>62</sup> and the other eye on the rule against restraints on alienation.<sup>63</sup> While a straight right of first refusal granted to the city is probably not a violation of the rule against restraints on alienation, conditions which set a price which might be lower than that elsewhere attainable may not be valid.<sup>64</sup>

In summary, a city seeking to adopt an ordinance to implement the low-moderate income housing element of its general plan must give careful consideration to the drafting of the language in the ordinance, the declaration of covenants, conditions and restrictions to be approved in connection with the creation of a condominium, the conditions placed upon tentative map or condominium diagram

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62. CONDOMINIUM HANDBOOK § 14.

63. CAL. CIV. CODE § 711 (West Supp. 1976).

64. 3 B. WITKIN, SUMMARY OF CALIFORNIA LAW 2026 (8th ed. 1973).

approval by the city, and the grand deeds for the below market units.

#### B. REGULATION OF CONDOMINIUM CONVERSIONS:

In the midst of the condominium conversion craze, a number of cities adopted ordinances restricting the conversion of apartment buildings into condominiums. One such ordinance requires the owner of an apartment undergoing conversion into condominium to give tenants 90-day lease extensions and 90-day preemptive purchase rights.<sup>65</sup> It further provides that applications for approval for tentative maps for condominium conversions will not be approved if the rental apartment vacancy rate in the city is three percent or less at the time of the application, unless two-thirds of the tenants consent in writing to the conversion.<sup>66</sup> Another city passed an ordinance<sup>67</sup> which requires the developer who wants to convert an apartment to a condominium to refurbish or restore the apartment to "as built" condition insofar as feasible and further requires<sup>68</sup> him to submit a plan to accommodate tenants of apartments sought to be converted with specific reference to relocation assistance, sale preferences to present tenants, availability of substitute accommodations and notice of termination of tenancy.<sup>69</sup> These and similar ordinances are based upon the requirement that the general plan make adequate provision for the housing needs of all economic segments of the community,<sup>70</sup> coupled with the belief that there is some magic in preserving a certain balance between owners and tenants within a given geographical area.

The regulation of condominium conversions and the requirement of a certain number of below market units in a new development are methods of regulating land use at a very basic level. The underlying sociological premise, however, requires close scrutiny. One is tempted to ask: what is so important about having a fixed percentage or ratio of low-income owners or of tenants within a particular community? What are the evils that to which people will be subjected if the city does not take steps to insure a "proper" mix of economic groups and of owners and tenants? What is a "proper mix"? Who decides? Has it been conclusively established that al-

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65. PALO ALTO, CAL. CODE ch. 16.38, § 16.38.050.

66. PALO ALTO, CAL. CODE ch. 21.33, § 21.33.050.

67. MENLO PARK, CAL. CODE ch. 15.34, § 15.34.050.

68. MENLO PARK, CAL. CODE ch. 15.34, § 15.34.050.

69. CONDOMINIUM HANDBOOK § 150.

70. CAL. GOV'T CODE § 65302(c) (West Supp. 1976).

lowing the free market to regulate the mix of economic groups of owners and tenants is basically bad? Has it been demonstrated that artificial manipulation by local or regional government will be better? If what we are really saying is that as a matter of social and political policy we should provide low-moderate cost housing for those who cannot afford it, would it not be more honest, and a good deal simpler, to create a local housing element, construct low-moderate cost housing, and raise the tax rate to pay the cost? Would it be better still to pay direct subsidies to persons qualified for purchase of the housing?

By the same token, if the city can establish a genuine public interest in artificially preserving a vacancy rate in rental housing in order to provide adequate opportunities for rental to those who are unwilling or unable to purchase housing, the city could pay rent subsidies to those who are qualified. As long as there are tenants demanding space, the market price will control and establish a reasonable vacancy rate.

#### CONCLUSION

California has a scheme of statutory and administrative regulations which covers the development of condominium projects quite comprehensively. However, this scheme of regulation does little to provide solutions to problems arising from day-to-day condominium operation.