SWEDELSON & GOTTLIEB
COMMUNITY ASSOCIATION ATTORNEYS

11900 W. Olympic Boulevard
Suite 700
Los Angeles, CA 90064
Telephone: 310/207-2207
in CA: 800/372-2207
Facsimile: 310/207-2115

Hooray, AB 2502 is Dead; But What About the Waiver and Partial Payment Issues, and Why Did CLAC Support this Bill?

By David C. Swedelson, Swedelson & Gottlieb

As we reported in April, Assemblymember Julia Brownley had proposed AB 2502, which would have made assessment collection in California even more difficult than it already is. We have great news. Because of all of the opposition she received and because some of those that backed the bill withdrew their support when Brownley amended the bill, Brownley likely realized that compromise was impossible, the bill never made it out of committee and it did not advance to the floor for a vote.

This legislation would have imposed new and unwarranted restrictions on the assessment collection process for California community associations. Without any showing that there was a need for this new law, this proposed new legislation would have protected delinquent owners at the expense of their associations and all of the owners that timely pay their fees and/or assessments.

Brownley had agreed to and did amend the bill to eliminate the requirement that associations wait until the delinquent owner owed $3,600 or was 18 months delinquent before foreclosing. But she had left in the proposed prohibition on a waiver of the provisions of Civil Code Section 1367.1 relating to the allocation of payments, as well as the proposed prohibition on not accepting partial payments, and we learned that these issues were not only misunderstood by the legislator, but by others in the community association industry as well.

Let us first deal with the waiver issue. At first blush, we can understand concerns about homeowners being requested to waive

Branch Offices

Orange County
5000 Birch Street
Suite 3000, West Tower
Newport Beach, CA 92660
Telephone: 949/476-3789
Facsimile: 949/752-2160

Ventura County
1484 E. Main Street
Suite 200
Ventura, CA 93001
Telephone: 805/650-7899
Facsimile: 805/653-2518

Inland Empire
3400 Inland Empire Boulevard
Suite 101
Ontario, CA 91764-5510
Telephone: 909/476-3530
Facsimile: 909/460-0018

provisions of the Civil Code. And frankly, we have no problem with any amendment to the Civil Code which would restrict the waiver of the provisions of the Code as it relates to the application of payments made by a homeowner so long as the waiver does not apply to payment plans.

However, a blanket prohibition on a waiver of the application for payments as part of a payment plan (which is a negotiated contract between the delinquent homeowner and his or her homeowner association) would seriously impact a community association's ability to collect all that it is owed by a delinquent owner. More importantly, a blanket prohibition on this waiver is contrary to the original legislative intent. In order to best understand this waiver issue, we need to look back at the legislative intent of the amendment to Civil Code Section 1367.1 that first addressed this waiver issue.

Referring to the legislative history of Civil Code Section 1367.1 that deals with a prior amendment that addressed the application of owner payments (requiring that payments be first applied to principal, which, by the way, is contrary to the law in many other states), the Governor's Chaptered Bill File includes a letter from then Assemblywoman Speier bearing on the intent of the allocation provision amendment, and indicates that this proposed change in the law came about because "current law invites overreaching by collection firms..." and goes on to describe the "treadmill wherein the collection costs continue to accrue despite good faith efforts of the homeowner to cure any back debts." She goes on to say, "At some point, the management firm may recommend nonjudicial foreclosure. It is therefore critical that payments toward assessment debts be applied toward the principal obligation in order to minimize the costs of a dispute and to hasten full payment of all obligations." In a parenthetical, she adds: "We have been informed that some collections contracts are written to require that payments by association members be applied first to collection costs and only secondarily to the underlying debt owed to the association."

What is important to understand is that having the owner agree to the waiver in a payment plan agreement is not overreaching and will not create an environment where the "treadmill" that was referenced by

Assemblywoman Speier can occur. If the owner agrees to the payment plan and waives their rights under the Civil Code and makes the payments, their debt is satisfied and *they incur no additional late fees, interest, and collection fees and costs.*

There are important and practical reasons why California community associations need some leeway in contracting with their members. A blanket prohibition on waivers is not appropriate, as waivers are not prohibited, especially when they are not against public policy.

It is of course worth mentioning that association boards do not have to agree to any payment plan, and if waivers are prohibited, that could result in boards refusing otherwise reasonable payment plans, so as to avoid owners that game the system, as many do. Thus, an association should be able to ask that a delinquent owner agree to a waiver of Civil Code 1367.1(b) regarding the application of their payments when that waiver will not harm or injure that owner as will be explained in more detail below. Without this waiver, an owner could agree to pay their debt to their association and then stop paying after their principal has been paid, leaving the tab for the association and with no other option but to terminate the collection process, pay the collection fees and costs incurred to the collection service/attorney and then chase down the owner in small claims court. In other words, the waiver helps deter owners from "working the system".

It is one thing to restrict waivers if the waiver is being requested and as a consequence the homeowner may suffer some sort of damage, like additional late fees, etc. It is another thing to interfere with an association's ability to enter into a payment plan agreement with a seriously delinquent homeowner where *the waiver that is being requested causes no harm to the delinquent homeowner* but ensures that they don't abuse the system and protects the association and its prompt assessment-paying members.

Here is an example of an all too familiar situation: A homeowner is seriously delinquent in the payment of their assessments and they owe $2,500 to their association for unpaid assessments (fees), late fees, interest, and collection fees and costs. Let's assume for the sake of this example that the homeowner owes $1,800 in delinquent and

unpaid assessments, and $700 in late fees, interest and collection fees and costs.

If an association were required to accept a partial payment and/or if an association was not allowed to require that the delinquent homeowner waive the provisions of the Civil Code with respect to the application of their payments in entering into a payment plan, a homeowner could make a payment any time they want which could negatively impact the collection process (requiring that the association start over) and worse yet, it could allow the delinquent homeowner to pay only the $1,800 in delinquent assessments and have that payment allocated strictly to the principal (delinquent assessment), leaving the association without any practical remedy for collecting the $700 of interest, late fees, and costs. Such a result would force the rest of the paying membership to shoulder the burden of the unpaid collection costs.

While the association could likely survive (move on) without the interest or late fees (even though there is a Civil Code sanctioned penalty that should be imposed on a homeowner for untimely payment of their assessments), the association would then have to pay the collection service the fees and costs for services rendered and stop the collection process, as the board cannot require the collection service to move forward with foreclosure solely for unpaid fees and costs.

There is precedent for this waiver. For example, parties in litigation who make a settlement are often requested to sign settlement agreements that waive the provisions of Civil Code Section 1542. That code section provides that a settling party does not release unknown claims. California law does not prohibit a party from requesting, as part of a settlement, that the other party waive any unknown claims.

We are concerned that the forces that proposed AB 2502 may come back and try to implement this type of legislation in the future. It is important that we all know and understand the consequences. It is one thing to restrict associations and their management companies from requiring that homeowners waive provisions of the Civil Code so they don't end up in a spiral with their payments being solely allocated to

costs and fees leaving them late each month they pay. But once they are in collections, and a payment plan is being offered to them, the delinquent owners are not going to suffer any harm or any extra fees as a result of being requested to waive the application of the Civil Code as it relates to the application of their payments during the term of the payment plan.

Using the example described above, if any owner was delinquent in the total sum of $2,500, our boards will sometimes instruct us to offer a payment plan where the owner pays that total sum over a period of six (6) months. If they pay in full, how have they been harmed? So instead of allowing a homeowner to pay $1,800 on a payment plan and avoid having to pay the fees and costs that have been incurred, the association should be allowed, once the homeowner is in collection and as part of a payment plan arrangement (which is a settlement), to ask that the homeowner waive the provisions of the Civil Code with respect to the application of their payments during the term of the payment plan only. This is not the issue that Assemblywoman Speier was trying to deal with when she first sought to amend the Civil Code with respect to the application of the payments.

Community associations should also not be required to accept partial payments in all circumstances, especially once the Civil Code 1367.1(a) required pre-lien letters are sent to delinquent owners. It is important to note that there are many cases in California law that clearly indicate that a creditor is not required to accept partial payment from a debtor, the delinquent homeowner. The Davis-Stirling Act is replete with provisions that discuss a delinquent homeowner entering into a payment plan with the association and therein the association agrees to accept partial payments. Note where Civil Code Section 1367.1 provides that the Board needs to address any payment plan proposals submitted by a homeowner. This further evidences the legislature's intent that delinquent homeowners not be allowed to unilaterally just make any payment they want, whenever they want, towards their delinquent account.

You may be asking yourself, what is the harm in accepting a partial payment? As noted above, a homeowner may pay $1,800 toward their $2,500 obligation and without the waiver of the Civil Code that I

have discussed above, that payment would have to go to principal, leaving the association without any practical recourse to collect the late fees, interest, and the collection costs and fees that the association has incurred. This means that all of the other homeowners that have timely paid their assessments will end up having to pay a portion of that homeowner's fees and costs of collection obligation.

In addition, if the association were obligated to accept a partial payment at any time in the process, there would be no reason for a payment plan agreement in the first place. Further, the association would be harmed in that depending on when the money is paid and accepted, the association may have to start the collection process over. For example, if the association sends out the pre-lien letter and the homeowner then sends in a partial payment, if the association were required to accept that partial payment, the association would then be required to send out a new pre-lien letter before it could record the lien (setting out the correct amount owed) delaying its collection efforts by thirty to sixty days.

Further, the application of the provisions of the Davis-Stirling Act related to delinquent assessment collections must not run afoul of Federal and State Fair Debt Collection Practice laws which prohibit misrepresentation of the debt. In the example above, if a pre-lien letter is sent and then a partial payment is accepted, even if only for a small amount, a new pre-lien letter must be sent that accurately reflects the debt. Not only would an unfettered requirement to accept partial payments impact the association's ability to secure the debt, but it also then requires incurring additional fees for the collection service to send a revised letter and accounting to the delinquent owner.

We just don't see that there is a public policy issue or concern that requires that the Civil Code be revised yet again to limit an association's ability to negotiate with its delinquent homeowner regarding the payments they will make and how they will be applied.

As stated above, AB 2502 is dead. But while it was bleeding out, we are informed and advised that one of the California Legislative Action Committee's (CLAC) representatives was pushing for the bill to remain alive even though it still contained the waiver and partial

payment prohibitions. And we are informed and believe that CLAC originally took an opposed position to AB 2502, but then supported the bill after some but not all amendments were made. Why? Politics? Some hard questions need to be asked of CLAC's representatives as to why they would ever support legislation that would have such a negative impact on California community associations. It just makes no sense. Let's hope this legislation does not resurface in the future.