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Department of Financial Protection and Innovation
Legal Division
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Via email

COMMENTS, ANALYSIS, AND RECOMMENDATIONS FROM THE CENTER FOR CALIFORNIA HOMEOWNER ASSOCIATION LAW RESPONDING TO THE INVITATION FOR COMMENTS ON PROPOSED THIRD DRAFT RULEMAKING UNDER THE DEBT COLLECTION LICENSING ACT

(FILE NO. PRO 05-21)

THE IMPORTANCE OF OFFERING A THIRD ROUND OF DRAFT REGULATIONS

The Center for California Homeowner Association Law ("CCHAL") is a 501c3 nonprofit founded 20 years ago by consumer attorneys to represent association homeowners in Sacramento before the Legislature. We thank the Department of Financial Protection and Innovation ("Department") for inviting comments on the third draft of rules governing the Debt Collection Licensing Act, because the invitation creates the opportunity to re-visit a consumer protection regulation impacting the chief financial asset of fully 35% of the State's population: their homes. We urge a re-examination of the regulations governing

- the Scope of the Act
- proposed exemptions to it and
- key definitions in Section §1850.2

Of concern to our Center is the class of debt collectors, who seem to have been overlooked by the draft regulations or else specifically exempted from the Act. These are the debt collectors whose sole business is to collect assessments levied by California's 55,000 homeowner associations ("HOAs") and alleged to be in arrears. These companies comprise a fairly small but well-defined class of debt collectors whose prime legal tool for forcing payment is foreclosure, either threatened or actual. Some companies are LLCs, some are law firms, some are subsidiaries of law firms. We have tracked their activity for two decades in California via court cases and independent research. In some instances, the law firm has been retained as

counsel by the HOA board, advising it on its collection policies and then implementing those policies via the law firm's collections subsidiary[1]. In some instances the debt collector functions as trustee supervising the foreclosure auction itself.

Given that California HOAs levy on consumers an estimated $200 million dollars annually in assessments,[2] debt collection in this specialized realm constitutes a potentially lucrative business for this class of debt collectors. Section §1802.5 of the draft regulations exempts homeowner assessments and those who collect them from licensing and regulation; we recommend that these exemptions be re-examined.

SCOPE OF THE ISSUE AND ITS BACKGROUND

California has about 55,000 homeowner associations; about 14 million Californians live in them, that is: 30-40% of the state's population. HOAs are quasi-governmental entities formed under the Nonprofit Mutual Benefit Corporations Code. They are self-financed through assessments that pay for many services formerly provided by cities and counties, for example water and sewer services. Last year's SB900 started requiring HOAs to "maintain, repair, and replace" all utility lines coming into the subdivision.[3] This new obligation will also be financed via assessments.

California HOAs levy an estimated $200 million in assessments annually. If a homeowner is alleged to be late in paying assessments, the HOAs force payment by turning the account over to a company whose sole business is assessment debt collection. This special class of debt collectors is currently neither licensed nor regulated by the state.

BASIS FOR COMMENTS FROM THE CENTER FOR CALIFORNIA HOA LAW

Our comments on the proposed rules and our recommendation are derived from

- the Center's own catalog of assessment dispute cases filed by homeowner plaintiffs in California state courts and federal courts.
- homeowner complaints about assessment collection lodged with our Center that did not rise to the level of litigation
- case studies provided by offices of California lawmakers and housing advocates like Public Counsel and Bay Area Legal Services.

Causes of action in litigation typically involve

- **Violations of the FDCPA**, particularly debt validation issues, for example: is the assessment truly owed? Can the dollar amount be verified? Was the owner

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[1] See ***David Donnell v Snowshoe Springs Association***, United States District Court, Eastern District 2001. See also ***Stockton Record*** "Group halts foreclosure against ailing homeowner," reporting that, unknown to the HOA, the ex-wife of the HOA's law firm was the foreclosure trustee.

[2] Estimates come from the California Law Revision Commission during its ten-year study of laws governing HOAs. See "Common Interest Development Law," Study H-850 https://clrc.ca.gov/H850.html. See also ***California Community Association Statistics*** published annually by Levy Erlanger Co., San Francisco.

[3] Chapter 288, 2024 Statutes amending Civil Code Sections 4775, 5550, and 5610.

informed of his right to dispute the charges? [See for example ***Santaella & Ramsey v Bridges Homeowner Association***, in which the owners had paid the $500 annual assessment ***in advance*** but their home was nonetheless scheduled for auction by Angius & Terry Collections. They sued in small claims court, won on appeal, and recovered costs.[4]]

- **Violations of California's Bus & Prof Code §17200 et seq** prohibiting unfair business practices
- **Violations of multiple sections of California's** Civil Codes[5] governing the **levying and collection of assessments**, in particular the proper application of a homeowner's partial payments to the assessment debt, a process clearly governed by Civil Code §5655 but whose violation is a routine cause of action in litigation. Instead of applying the homeowner's entire payment to discharging the principal – as the law requires -- the debt collector applies only a portion of the payment in order to keep the debt on the ledger. Last year's ***Doskocz v Association Lien Services***[6] from the California Appeals Court First District illustrates the point: what began as a $1239.08 assessment debt escalated into an attempted foreclosure as payments were not properly credited. Keeping the debt on the ledger is a strategy for "churning" the account for additional collection costs. An employee of one HOA collections company – a law firm -- detailed in a lawsuit how the "churning works. An attorney herself, she was terminated for her refusal to participate in the scheme.[7] Debt collectors try to evade Civil Code §5655 altogether by telling owners they won't accept partial payments unless they waive their right to the strict application of payments. Two published California Appellate rulings are relevant here: Arlyne ***Diamond v Sup Court*** (***2013) 217 Cal. App. 4th 1172*** and ***Huntington Continental v the JM Trust*** ((***2014) 230 Cal.App.4th 590***. [8] ***Diamond*** requires strict compliance with noticing and other procedural requirements during collections in order for a lien to be valid and ***Huntington*** permits the owner to make partial payments to the association – bypassing the debt collector – and the HOA is required to accept the payments.

NATURE OF ASSESSMENTS OWED: CONSUMER CREDIT OR CONSUMER DEBT?

Section §1850.2 "Consumer Credit Transactions" exempts from regulation the collection of (2) Debt owed pursuant to a Homeowners' Association Declaration of Covenants, Conditions, and Restrictions or other equivalent written agreement."

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[4] ***Yvette Santaelloa & Rex Ramsey v the Bridges Homeowner Association***, Contra Costa County Sup Ct. Case No. WSC-08-1071.

[5] Often called the Davis-Stirling Act. However, HOAs are also governed by the Nonprofit Mutual Benefit Corporations Code §§7110-8910

[6] ***Doskocz v Association Lien Services, First District Court of Appeal, Division One Contra Costa County Super. Ct. No. MSC17–01486), May 2024*** See also ***Gena Hanson et al v JQD dba Pro Solutions, US District Court Northern District.*** Settlement reached 2016. Documents available on request.

[7] See ***Flora Canaj v the Judge Law Firm*** Orange County Sup. Ct Case No.20-2012-00686419-CU-WT-CJC

[8] CCHAL campaigned successfully to get both ***Diamond*** and ***Huntington*** published. California Attorney General Kamala Harris requested publication of ***Diamond***.

We urge that this exemption be re-visited given the rulings in federal court on the nature of assessment debt and a re-visit of definitions in the Financial Code governing the Licensing Act.

A federal appeals court ruled in July 1997 that community association assessments are indeed consumer debts under the Fair Debt Collection Practices Act. The Seventh Circuit Court of Appeals issued the ruling in the consolidated case of ***Newman v. Boehm, Pearlstein & Bright, Ltd. and Riter v. Moss & Bloomberg,*** Ltd. Following the ruling, managers and attorneys in the Seventh Circuit--Illinois, Indiana, and Wisconsin—were to comply with the Act's disclosure requirements when collecting delinquent assessments. The Seventh Circuit ruling was reaffirmed in the U.S. District Court for the Southern District of California -- also in 1997 -- that association fees are consumer debts. The Court refused to dismiss ***Thies v. The Law Offices of William A. Wyman v Champs/the Kelly Group.***

Moreover, the Financial Code §100002(f) clearly defines "consumer debt" as "money, property, or their equivalent, due or owing, or alleged to be due or owing, from a natural person by reason of a consumer credit transaction. The term "consumer debt" includes a mortgage debt."

Like mortgage debt, assessment debt is collateralized with the consumer's property: his home. In fact, the chief collections tool used by association debt collectors is the same one used by a lender -- the threat to seize the home and to auction it off, a threat the debt collector is permitted to make 30 days after assessments are due. (See Civil Code §5660). The minimum bid at auction is the amount (allegedly) owed and not the home's market value. The auction of a $285,000 home in Calaveras County to recoup a $120 annual assessment triggered public hearings in Sacramento.[9]

Few consumers know what their rights are under state and federal fair debt collection laws during the collection process or how to counter the threat of foreclosure. Even fewer know that they have rights under ***Diamond*** and ***Huntington***.

Like mortgage debt, the legal steps for collecting assessment debt are laid out not only in statute but also in a recorded document, namely the association's Covenants, Codes & Restrictions ("CC&Rs"). Again, without discussion, the draft regulation has exempted the terms of this document from oversight.

HOMEOWNER CONSUMER PROTECTION: THROUGH LITIGATION OR REGULATION?

To address this topic, we urge DFPI to consider the business model of the companies collecting assessments. We know from extensive examination of HOA Notices of Default (NODs) that the dollar amount of assessments alleged to be owed tends to be small: often in the $500 -- $1500 range, though the unregulated collection costs levied by the debt collector can easily double, triple, or even quadruple the charges.[10] The

[9] See "Does the Punishment Fit the Offense?" informational hearings on the HOA use of foreclosure. Convened by the Senate Housing Committee February 17, 2004, Sacramento.

[10] See the ***Hanson*** case in which three monthly assessments of $255 ballooned into a $1995 bill. See also ***Rawnsley v Lakeside Community Association, Sacramento County Sup Ct. Case No.10SC011848.*** The homeowner owed

interest rate cap on the debt – under Article XV the state constitution -- has been removed by statute. (See Civil Code §5650(c).

We have presented this data in multiple legislative hearings in Sacramento and also in the Senate's informational hearing on HOA foreclosures[11] prior to the introduction of several bills meant to restrain the use of foreclosure as a collections tool.

Given the relatively small size of the debt, some homeowners – but not all – conclude that it is easier to pay the money demanded by the debt collector than to try and find -- and pay -- an attorney to fight the charges. Adding to the homeowner's difficulty is the challenge of finding an attorney versed in the complexities of levying assessments and the valid process for collecting them. Income-qualifying homeowners can approach Legal Services for help, but moderate-income homeowners are left on their own. The debt collector's business model rests on these facts: the debt is relatively small, and the homeowner is unable to find affordable, knowledgeable legal services to help in disputing the charges or exercising his consumer rights, e.g. making partial payments directly to the HOA as permitted under ***Huntington***. Instead of fighting what the debt collector demands, the homeowner pays – because his home is held hostage to foreclosure.

SHOULD ATTORNEYS AND LAW FIRMS BE EXEMPTED FROM THE ACT?

The author of SB908, Senator Bob Wieckowski, was adamant on this point—that attorneys and laws firms not be exempted. The Senate Banking Committee made this plain in its analysis, saying **"**This bill's author has also declined to provide a debt collector licensing exemption for attorneys on the following grounds: "*Law firms operate as debt collection mills. They send collection notices on law firm letterhead and send communications to consumers using the law firm's name. There is only one reason for this overlap in professions: because it works. Consumers see a notice from a law firm alleging they owe a debt. They are intimidated and frightened that they're being sued or will be sued, even though most often that is not the case. To exempt attorneys from licensure would blow a huge hole through the licensure law."* (See Senate Banking Analysis of SB908 April 15, 2020.)

The clearest example we offer to illustrate Senator Wieckowski's point is last year's ***Doskocz v Association Lien Services (ALS)*** in which the First District Court of Appeal found the two principals of the law firm -- David Swedelson & Sandra Gottlieb -- were "alter egos" of and indistinguishable from their collections company ALS. For multiple violations of the FDCPA and state statutes, the First District levied $1.173,816 in damages, court costs and fees – and held the two attorneys personally liable for it. This behavior is, unfortunately, not an isolated example as we hope we have shown in this commentary.

PROTECTING THE VULNERABLE THROUGH REGULATION: WHO IS AFFECTED?

$205 in assessments, but Angius & Terry Collections levied $1614 in collection costs. The owner paid under protest to forestall foreclosure but recovered his payments before trial.

[11] See note 9 above.

Californians fortunate enough to own a home likely count it as their chief financial asset. For many families, buying an association home is the first – and most affordable – rung on the wealth-building ladder. However, the unregulated process of assessment debt collection threatens the financial well-being of seniors and households of color among others.[12] One startling fact emerged from our own research – a fact we weren't looking for – was the extent to which Notices of Default are recorded against Hispanic households, a figure far out of proportion to their numbers in the census.

We are happy to clarify any recommendations made here and to provide data referenced in our recommendations – on NODs, for example – along with our testimony before policy committees, court records, news reports, research and other documents. We reference them to support our urgent request that

- the Licensing Act identify homeowner assessments as consumer debt under the Financial Code and that
- any entity trying to collect assessments be licensed and regulated.
- "Entities" shall include law firms and subsidiaries of those firms.

Regards –

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[12] See for example "Hard-pressed Owners Facing Another Financial Threat," ***New York Times***, April 13, 2011. Filipina immigrant Estrella Bryant, age 70, owed $560 in assessments and Association Lien Services (ALS) levied $2500 in collection costs on the debt.