COMMENTARY RE: CAI LAC NJF BILL

1. CAI LAC proposes an alternative to the task force bill due to perceived deficiencies in that bill which cannot readily be amended on a piecemeal basis. The LAC bill fairly balances the needs of consumers who default and the needs of other consumers who would be unfairly burdened with paying the defaulting owner's share of assessments.

2. The task force proposal would have limited, if any, advantage over a judicial foreclosure and would be likely to go largely *unused*. The LAC bill would be used by associations.

3. The task force bill contains poison pills. The task force's proposed section 667-I provides that the "association or any other person having a recorded lien" can credit bid at the auction. This means that the association would go to the expense of the auction but that the mortgage lender could be the successful bidder 100% of the time. Since the credit bidder would pay nothing, the association would receive nothing. The entire process would only serve to increase the loss incurred by the association. See also the task force's section 667-K(b)(1). This provision, too, means that the association would suffer the expense and yield nothing.

4. The task force proposal also contains several provisions that would impose meaningless and counterproductive additional burdens on associations that were not included in Act 48. That is, the task force proposal goes entirely in the wrong direction.

5. The LAC bill would provide abundant due process and an absolute minimum of 158 days (over five months) from delinquency to sale. In the real world, a longer period can reasonably be anticipated.

6.

Pre-collection	60 day delinquency
Demand letter	35 days to pay
Foreclosure notice	35 days to pay or start pay plan
Public notice of sale	28 days minimum to sale
Days from delinquency	158 minimum to sale
Closing	45 days maximum w/exception
Days to close up to	203

7. The specific provisions of the proposed LAC bill follow:

Alternate power of sale process

Like the task force bill, the LAC bill proposes adding a new part to chapter 667 that is available to chapter 421J and chapter 514B associations. This is sufficient to capture condominiums that have yet to adopt the optional provisions of chapter 514B.

Definitions

These provisions are not expected to be controversial.

Notice of default

The LAC bill treats the notice of default separately from the notice to owner of intention to foreclose. The attorney's demand letter following a minimum 60-day delinquency constitutes notice of default. The owner has 35 days to pay (which is at least 95 days after the delinquency began). Many owners pay in response to a demand letter. There is no reason to increase the stress on owners by coupling notice of intention to foreclose with the notice of default.

There is more than a reasonable basis to tie the payment plan opportunity to the notice of default but LAC has, instead, proposed providing additional time to the owner by linking the payment plan opportunity to the subsequent notice to owner of intention to foreclose.

Notice to owner of intention to foreclose by power of sale

Not less than 35 days after notice of default is sent to the owner, the association may send notice of its intention to foreclose. The owner may request a payment plan.

A payment plan is commenced by paying 10 percent of the amount due within 35 days after the notice of intention to foreclose is sent. That is, the owner could stay a foreclosure after being delinquent for a minimum of 140 days (over four-and-a-half months) merely by delivering 10 percent of the amount due. Such a nominal sign of good faith is appropriate.

LAC notes its deep concern that mandating payment plans creates an incentive to ignore the payment obligation. It is also true that other consumers will be subsidizing the delinquent owner's default. LAC understands that policy makers want a payment plan option, however, and this proposal is more than reasonable.

The contents of LAC's notice of intention to foreclose differ from the task force bill in other ways as well because the task force bill has several deficiencies. Without limitation, the task force imports concepts from the mortgage arena into its notice. Those concepts have no relevance to associations and reflect an erroneous view of the process. There is also extraneous detail of no practical value to a consumer.

For example, the task force fails to recognize that only monetary defaults will form the basis for an association to exercise the foreclosure remedy (667-B(a)(4)). Also, the task force requires a statement that "the entire unpaid balance of the moneys owed to the association will become due[.]" (Emphasis added) That is a mortgage foreclosure concept relating to the *acceleration* of a mortgage so that the entire balance of the mortgage will become due if a default remains uncured. In contrast, an association will be seeking to collect amounts that are already delinquent.

Extraneous details of no practical value include the requirement to include the transfer certificate of title ("TCT") number (for land court property) in the notice. Since this is a notice to the **owner** it is a meaningless requirement.

Owners recognize their address. Few, if any, even know their tax map key number. Fewer still will know the TCT number.

The TCT number would add no value to the consumer but would create an artificial opportunity to claim that the foreclosure was defective if the TCT number were omitted. Note, also, that the task force does **not** provide for inclusion of the TCT number in the *public* notice. The TCT number is not important.

Similarly, the task force proposes that various matters be enumerated in the notice but that extra verbiage should then be added in large print. The extra verbiage adds no value and may confuse consumers. The notice should be clear without

repetition or amplification. The LAC proposal includes "A statement that the owner should consult an attorney licensed in the state for an explanation of the owner's legal rights and possible defenses to the foreclosure."

It is worth noting that Rule 4.3 of the Hawaii Rules of Professional Conduct prevents an attorney from providing legal advice to an adverse party. The task force proposal would arguably be forcing the association's attorney to violate Rule 4.3.

Rule 4.3. DEALING WITH UNREPRESENTED PERSON.

(a) In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding.

(b) During the course of [the lawyer's] representation of a client a lawyer shall not give advice to a person who is not represented by a lawyer, other than the advice to secure counsel, if the interests of such a person are or have a reasonable possibility of being in conflict with the interests of [the lawyer's] client.

LAC provides that notice shall be mailed by first class mail and by certified mail, return receipt requested, to the unit and to the address provided to the association for its records if different. LAC also provides for three separate attempts to personally deliver the notice to the owner at the unit. LAC also provides for posting the notice conspicuously on the unit if personal delivery is not successful.

Act 48 specifically exempts associations from the requirement of personal service in the manner provided in the Hawaii Rules of Civil Procedure, but the task force seeks to impose that onerous obligation onto associations. The exemption should be preserved.

A personal service requirement in the manner provided in the Hawaii Rules of Civil Procedure essentially *turns a non-judicial process into a judicial process*. This is because court action is required if substitute service is necessary. Since the non-judicial remedy is often used precisely because an owner is hiding or has disappeared, substitute service will often be required. LAC proposes to make three separate attempts at personal delivery of the notice. That, together with the other avenues of providing notice, more than satisfies due process requirements and any other reasonable concerns.

Indeed, LAC proposes to provide greater notice than is required pursuant to Act 48. The task force bill would eliminate much of the utility of a non-judicial foreclosure remedy (in this and other particulars).

Recordation of notice to owner of intention to foreclose by power of sale

LAC proposes that an association *may* record the notice to owner of intention to foreclose by power of sale, with similar effect as a notice of pendency of action. The task force *mandates* this step.

Recordation is solely for the benefit of the association, by binding persons with after-acquired interests in the property to the foreclosure result. Mandating this step adds no value to the consumer and should not be regarded as an essential element of the process.

The task force proposal is also needlessly verbose and redundant. That is characteristic of the task force proposal as a whole. Added verbiage that seeks to explain the effect of recordation creates the opportunity to *argue* about the effect of recordation.

It is appropriate to specify that recordation of the notice of intention to foreclose will have the same effect as "the recordation of a notice of pendency of action under section 501-151 or 634-51, or both." There is ample case law explaining the effect of those statutes.

Stay of power of sale foreclosure by performance of payment plan

The LAC proposal provides for a stay of the power of sale foreclosure by performance of a payment plan in clear terms.

The task force payment plan language is ambiguous, poorly conceptualized and open to debate. One notable example is that the task force specifies that "a reasonable payment plan shall require the owner to pay, at a minimum, the current maintenance fee and **some amount** owed on the past due balance." (Emphasis added) That language is vague, ambiguous and unreasonable. Thus, the task force goes on to suggest that "a period of up to twelve months shall be reasonable." It has to be one thing or another.

If it is “some amount” then that language is a poison pill that will cause associations to shun the remedy. If it is a definite period then it is appropriate state the period clearly.

Law should not aid uncertainty. LAC proposes 10 percent monthly.

Public notice of public sale; contents; distribution

LAC provides for a relevant and useful public notice. LAC excludes the private information about what an owner owes, which may run afoul of the fair debt collection practices act and, in all events, is not a matter of public concern. LAC does propose to include an estimate of the opening bid.

LAC provides for notice that “the unit will be sold subject to liens with priority over the association’s lien.” The task force’s requirement to include the “name of any prior or junior creditors” provides no obvious benefit to the consumer and is yet another opportunity to claim a process defect over a detail that provides no protection to the owner of the unit.

It is sufficient to inform the public that the association foreclosure will be subject to priority liens. The claims of junior creditors will not survive the foreclosure process and potential purchasers should conduct independent due diligence.

The task force requires owners to pay the association in full three business days prior to the public sale. The traditional formulation is that payment must be made before the bidding is closed at the auction. There is no reason to prevent owners from making payment prior to the close of bidding at the auction.

Place and time of public sale

The task force proposal suggests that a public sale may take place sixty days after distribution of the notice of public sale but that is deceiving. The task force’s personal service requirement can derail the entire process. The process of serving pursuant to the Hawaii Rules of Civil Procedure can easily take six months. The task force’s open house requirement will not serve the consumer but will create the opportunity for factual disputes and delay. The task force proposal fails to reconcile the effect of delay on its timeline.

The place and time requirements between the task force bill and the LAC bill are, however, similar. LAC has no objection to conducting sales at designated state facilities. The nuance difference is that LAC provides that DAGS is *authorized* to designate which state facility to use. Under the task force bill, DAGS must designate what state facility to use. Inaction by DAGS could prevent non-judicial foreclosures on neighbor islands.

Postponement of public sale

LAC and the task force both provide for postponement and cancellation of the public sale. The task force repeats the error of regarding association debt as subject to being "accelerated" in its proposal. *Mortgage* debt can be accelerated. Associations seek payment of sums already due. The task force would also prevents owners from curing a default after "three business days before the date of the public sale[.]" Owners should be able to pay up until the time of sale.

Authorized bidders; successful bidder

The task force proposal contains a poison pill. It provides that "the association or any other person having a recorded lien" can credit bid at the auction. This means that the association would go to the **expense** of the auction but that the mortgage lender could be the successful bidder 100% of the time. The credit bidder would pay nothing, so the association would receive nothing. (Task force sections 667-I and 667-K(b)(1)).

The entire process would only serve to increase the loss incurred by the association. The task force provision renders the task force proposal useless.

LAC provides a workable alternative. LAC preserves current law which enables the association to credit bid.

LAC proposes to codify the usual practice of requiring bidders to display good funds equal to ten percent of the bidder's highest bid prior to the start of the public sale.

LAC specifies that the successful bidder has the duty to close the sale. LAC holds bidders responsible for failing to complete the sale. The task force would let bad faith or negligent bidders defeat the sale by merely sacrificing a down payment of several hundred dollars.

As a further mechanism to assure the success of the public sale, LAC proposes that if a successful bidder fails to complete the sale, then the association can match the successful bidder's bid or allow another to match the bid and complete the sale. This will guard against bad faith or negligent bidders defeating the sale by merely sacrificing a down payment of several hundred dollars.

Conveyance upon payment of purchase price; distribution of sales proceeds

The task force includes another poison pill in its section 667-K(b)(1) which provides for distribution of the proceeds by first paying: "All liens and encumbrances in the order of priority as a matter of law[.]" This, again, means that the association would incur the expense of foreclosure and receive nothing. Mortgages have priority over the association lien so any money realized would go to the lender.

LAC maintains current distribution protocols instead.

LAC also clearly specifies that any association sale would be subject to any lien for real property taxes and subject to mortgages recorded prior to the recordation of a notice of lien by the association. This matches current section 514B-146, with the exception that the words "real property" are included to clarify what taxes have priority.

Since this remedy is intended for planned community associations ("PCAs") as well, LAC takes into account that the project documents of some PCAs only accord priority to first mortgages.

Affidavit after public sale; contents

The task force provides that the "association" must sign an affidavit. LAC provides that a "representative of the association" sign because the association is an entity and cannot sign anything.

LAC provides that the representative "shall sign an affidavit, under penalty of perjury, that to the best of that person's knowledge, information and belief:" and listing things to be included. LAC merges the task force's comparable items (1) and (2) by saying that "the power of sale foreclosure was made

pursuant to and in compliance with the requirements of this part", "summarizing the actions taken on behalf of the association to complete the power of sale foreclosure" and specifying what must be attached to the affidavit. LAC allows for additional relevant documentation to be added. LAC's form of affidavit is more closely keyed to the actual statutory requirements than the task force proposal.

Recordation of affidavit and conveyance document; effect

The task force provides for recordation of the affidavit and the conveyance document between ten and forty-five days after the public sale. LAC provides for recordation within forty-five days after the public sale, but provides for a thirty-day extension to record in the event that the successful bidder fails to complete the sale and a new bidder is substituted. LAC also specifies that the failure of a public sale under this part shall be without prejudice to renew the process or to exercise other remedies.

The task force makes the mistake of asserting that the association's lien shall be extinguished from the unit upon recordation of the affidavit and conveyance document. That fails to take the lien provided for in section 514B-146(g) and (h) into account (12 months/$7,200 at present). LAC addresses that point and also makes clear that the unit remains subject to the association documents and to applicable statutes.

LAC also provides that the public sale forecloses the owner's interest in abandoned personal property left in the unit. Remaining provisions of the two proposals are generally in accord but the language and organizational differences are significant. For example, LAC refers to the "grantee" rather than the "purchaser" because the conveyance will be to a grantee. The LAC proposal is clearer.

Owner's liability for deficiency

The task force proposal (its section 667-N) is open to the interpretation that the association's remedy for collecting a deficiency must await the eventual and uncertain exercise of the lender's foreclosure remedy and subsequent payment of amounts payable pursuant to section 514B-146(g) and (h) into account (12

months/$7,200 at present). LAC provides that such amounts, if any, shall be credited to the foreclosed owner but does not require that the association await an uncertain eventuality to pursue collection of any deficiency.

Liberal construction to facilitate exercise of power of sale remedy

If the legislature chooses to allow a non-judicial foreclosure remedy, it should be an effective remedy. Judicial review should focus on substantial compliance rather than on trivial matters that might create uncertainty about the effectiveness of the remedy.

Other remedies; conflict with other provisions

It should be clear that the proposed new part of chapter 667 will control any non-judicial foreclosure process but that other remedies remain available.

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8. The task force proposes to amend HRS section 514B-146 and it proposes to add a similar section to chapter 421J. LAC supports parity for planned community associations but it takes exception to the task force proposals.

The task force proposes to amend HRS section 514B-146(a), in part, by providing "that a lien recorded by the association shall expire two years from the date of recordation; and provided further that no lien may be imposed by the association against any unit for any assessments arising solely from fines, penalties, or late fees."

That is an almost unbelievably unfortunate suggestion. **Who would ever pay fines, penalties or late fees if the association lacked an effective enforcement remedy**?

Existing law has it right. HRS Section 514B-146 is based on a pay first, dispute later basis. That section provides wholly appropriate remedies, including small claims court, mediation and arbitration in the event of an errant collection.

The task force rationale for lien expiration is not apparent. Assuming that *some* expiration period might be appropriate, the

appropriate period would be **six** years. See, HRS section 657-1(1):

> **§657-1 Six years.** The following actions shall be commenced within six years next after the cause of action accrued, and not after:
>
> (1) **Actions for the recovery of any debt founded upon any contract, obligation, or liability**, excepting such as are brought upon the judgment or decree of a court; excepting further that actions for the recovery of any debt founded upon any contract, obligation, or liability made pursuant to chapter 577A shall be governed by chapter 577A; (Emphasis added).

Association liens are contractual in nature and the contract statute of limitations would be the appropriate reference point ***if*** lien expiration were to be considered.

It is true that section 514B-146 must be amended to attend to contemplated changes to chapter 667. It is also true that section 514B-146 is a bit of a muddle in some ways.

LAC, therefore, proposes to amend section 514B-146 primarily through reorganization and simplification. Among other things, LAC proposes to add the words "real property" before the word taxes in subsection (a)(1). The existing provision is commonly understood to refer to real property taxes but the Internal Revenue Service has taken the position in litigation that income tax, and other tax, liens are within the scope of subsection (a)(1).

Other proposed changes are matters of simplification. Compare, for example, the existing proviso at the end of subsection 514B-146(b)

> provided that the mortgagee of record or other purchaser of the unit shall not be deemed to acquire title under paragraph (1), (2), or (3), if transfer of title is delayed past the thirty-six days specified in paragraph (1), the sixty days specified in paragraph (2), or the thirty days specified in paragraph (3), when a person who appears at the hearing on the motion or a party to the foreclosure action requests reconsideration of the motion or order to confirm sale, objects to the form of the proposed order to confirm sale, appeals the decision of the court to grant the motion to confirm sale, or the debtor or mortgagor declares bankruptcy or is involuntarily placed into bankruptcy. In any such case, the mortgagee of record or other purchaser of the unit shall be deemed to acquire title upon recordation of the instrument of conveyance

with the LAC proposal:

> provided that, with respect to judicial foreclosures, title shall be deemed to have passed, and the obligation to pay common expenses shall begin, upon recordation of the conveyance document or some earlier time determined by a court of competent jurisdiction if post-confirmation legal proceedings, or bankruptcy, delay entry of the order confirming sale.

Thus, LAC proposes changes to HRS section 514B-146 for clarity. With respect to the parallel 421J provision, PCAs sometimes provide for priority only for **first** mortgages, so 421J-__(a)(2), for example, should read: "(2) Liens given priority in the association documents."

9. LAC notes that HRS section 603-21.7 should be amended to prevent potential challenges to circuit court jurisdiction over judicial foreclosure of association liens. Removal of the "in like manner" language from HRS section 514B-146(a) raises the jurisdictional concern.

10. LAC notes that the task force proposes to amend HRS section 514A-90. That provision remains on the books but it has no practical effect.

Section 514A-90 is an analog to section 514B-146. See, section 514B-22, which provides that "part VI" of chapter 514B applies to all condominiums. Section 514B-146 is in part VI, so it applies to all condominiums.

11. There are other differences between LAC and the task force.

A. One is the notion that exercise of a non-judicial foreclosure remedy should be subject to liability for unfair and deceptive trade practices (chapter 480).

Associations should not be lumped in with lenders. The abuses attributed to lenders should not be generalized to punish associations. Assuming that some anomalous abuse may periodically occur within the association arena, LAC is unaware of any empirical basis for imposing chapter 480 liability on associations as a result.

It should be noted that HRS section 514B-104(a)(4) provides that associations may: "(4) Institute, defend, or intervene in litigation or administrative proceedings in its own name on behalf of itself or two or more unit owners on matters affecting the condominium. **For the purposes of actions under chapter 480, associations shall be deemed to be "consumers"[.]"** (Emphasis added). That is, associations **are** consumers and associations represent consumer interests.

When associations exercise collection or foreclosure remedies they are protecting the interests of the majority of the consumers at a project. Chapter 480 liability would just be a windfall in a litigation lottery and would harm the consumers who constitute the majority of the association owners.

B. The task force has an open house requirement. Several points are in order, by way of illustration:

i) an open house requirement would rarely, if ever, benefit an owner. Most association foreclosures involve units without equity. An owner with equity can avoid foreclosure by selling a unit privately;

ii) it is unreasonable to expect cooperation from an owner whose unit is being foreclosed;

iii) an open house would be an opportunity for rape, assault, theft, etc. and an opportunity for the false accusation of wrongdoing;

It is important to note that a foreclosure commissioner appointed by a court is a judicial officer subject to the control and protection of a judge. No such protection or control would exist in the non-judicial context.

The task force's open house proposal lacks merit. It would not benefit the owner. It would simply create an opportunity for a needless factual dispute, and could occasion crimes against persons and property.

C. This commentary merely addresses the portion of the task force bill that directly relates to the alternate power of sale process for associations. LAC reserves comment on the broader task force bill.