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IN THE SUPREME COURT
STATE OF ARIZONA

PETITION TO AMEND RULE 31(d), ARIZONA RULES OF THE SUPREME COURT	Supreme Court No. R-11-0001 **Comment of the State Bar of Arizona Regarding Petition to Amend Rule 31(d), Arizona Rules of the Supreme Court**

The State Bar of Arizona acknowledges that on December 30, 2010, the petitioners filed a proposal to amend Rule 31(d) of the Arizona Rules of the Supreme Court, and that they recently filed a comment striking some but not all of the language from their original proposal. The State Bar opposes both the original petition and the "compromise" version submitted by comment. Because the State Bar does not know which version the Court will ultimately consider, and because of the possibility that other comments will be filed too late for the State Bar to respond to them, the State Bar respectfully submits this comment, addressing all of the objectionable features of the original petition and the compromise language recently submitted by comment.

The proposed amendment seeks to permit homeowner association management companies (HOA managers) "to prepare, execute, and record liens on behalf of Associations; to communicate with homeowners and condominium unit

owners about unpaid assessments and fees; and to represent Associations in procedures before the small claims division of Arizona's justice courts."

The State Bar recommends denial of petitioners' proposed amendments for the following reasons:

1. The proposed petition would be tantamount to giving HOA managers the right to practice law, which is a significant departure from existing law and which right is already provided for in less intrusive exceptions to the rule, or could be provided by minor amendment to other, less intrusive, restrictions;
2. Recordation of liens for assessments against individual homeowners is not necessary;
3. Assessments for violations of CC&Rs cannot be enforced in small claims court and cannot be liens unless filed in a superior court;
4. HOA management companies' powers are already too broad and unregulated, without accountability to any licensing body; and they should be regulated, not given more powers; and
5. HOA management companies currently practice without duty, accountability, or liability to homeowners.

RATIONALE SUPPORTING DENIAL OF PROPOSED AMENDMENT

I. Unlawful Practice of Law

A. The practice of law is a matter exclusively within the authority of the judiciary.

The Arizona Supreme Court noted in *Hunt v. Maricopa County Employees Merit System Commission*, 127 Ariz. 259, 261, 619 P.2d 1036, 1038 (1980), that "[t]he determination of who shall practice law in Arizona and under what condition is a function placed by [Article III of] the state constitution in this court."

B. The proposed amendment is a significant departure from the existing exceptions in Rule 31.

Arizona Supreme Court Rule 31 codifies the standard that only Arizona-admitted lawyers may practice law in Arizona. However, Arizona Supreme Court Rule 31(d) also currently includes twenty-nine categories of non-lawyers who are permitted to engage in specific services that fall within the definition of the practice of law. All of the exceptions assure at least some competency standards and accountability for the non-lawyers who are providing legal services.

In virtually all of the exceptions authorized by the Supreme Court for certain non-lawyers to engage in some form of the practice of law, the non-lawyers' competence is assured because they are regulated by some code of conduct, *e.g.*, Rule 31(d)(16) and (17), for CPAs and enrolled agents, Rule 31(d)(24) for certified legal document preparers, Rule 31(d)(18) for paralegals under the supervision of lawyers, Rule 31(d)(19) and (23) for court personnel under the supervision of judges and government lawyers, Rule 31(d)(26) for registered property tax agents.

Other exceptions permit limited practice of law by individuals performing the services incidental to their work for their own companies (and not for the use of customers or clients – Rule 31(d)(20)) or for no charge (exceptions 5, 7, 8, 9, 10, 11, 12, 13, 15).

Contrary to all of these prior exceptions, this proposed amendment would not assure any accountability or competency requirements for the non-lawyer property managers who would charge homeowner associations for practicing law. There is no assurance that the property management companies will be bound by any regulations or code of conduct because they are not regulated under any state code of ethics. The proposed amendment expands the practice of law to unregulated individuals who charge associations a fee for practicing law – without any assurance that they have the requisite skills, experience, and knowledge to perform

the legal services – and without any licensing, code of conduct, or regulation whatsoever.

Under the amendment, property management companies would be authorized to prepare and record liens. That is the practice of law. UPL Advisory Opinion 04-01; s*ee also, Arizona Supreme Court Certified Legal Document Preparer Board hearings* (preparing liens is the practice of law*).*

Property management companies, under the amendment, would be authorized to appear in court on behalf of homeowner associations – and charge a fee for this legal representation. There are currently several exceptions in Rule 31(d) that permit small claims representation by non-lawyers, all of which either prohibit an individual from charging a fee for the service or require that the individual be licensed and regulated by some state or federal entity.

The purpose behind the regulation of who may practice law is to assure *accountability and competence.* Arizona has led the nation in authorizing appropriate categories of non-lawyers to provide legal services to the public in the form of self-service centers at superior court and by the Supreme Court certifying Legal Document Preparers. This state does not have a "protect lawyers" mindset – it has a "protect the public" mindset.

The two most recent additions to Rule 31(d), subsections (28) and (29), both authorize non-lawyers to represent entities or individuals in administrative proceedings, *as long as they are not charging a fee.*

The exceptions enumerated in Rule 31(d) assure that individuals who are charging a fee to practice law are at least competent to do so and accountable under some regulatory authority. This amendment does neither. It merely authorizes non-lawyer property management companies, who are not regulated by any state code of ethics, to charge a fee to homeowners associations to practice law, in court, without

any assurance that the property management companies are competent to provide such legal services and without any level of responsibility established by any regulatory authority.

C. The amendment is objectionable on technical grounds.

Subsections (d)(3) and (d)(7) of Rule 31 already permit an officer or employee of a corporation or HOA to appear in justice court and small claims court on behalf of the organization; so that portion of the proposed rule that allows a duly authorized officer, director or employee to represent the entity in small claims court is redundant. As mentioned above, unlike subsections (d)(3) and (d)(7), there is no restriction in the proposed rule that limits the representation to officers who are not charging a fee or when the representation is not an officer's primary duty.

As explained above, the drafting of liens is the practice of law. *See* Rule 31(a)(2)(A)(1). The proposed exemption permitting a non-lawyer to draft a lien affecting the rights of the parties, to be recorded as a matter of public record and relied on by parties reviewing the public record, is beyond the scope of the other exemptions contained in Rule 31(d) and would set a dangerous new precedent. The exemptions generally provide for limited representation in particular settings, not drafting legal documents which would affect the rights of the parties and would be reviewed and relied on by third parties.

Executing (as opposed to drafting) a lien is not the practice of law if it is done by a real party in interest. However, it is the practice of law if execution is done by a third party on behalf of another person or entity. As appropriate, officers, directors and employees may be able to execute liens under the governing documents. They do not need authorization by rule to do so. The Supreme Court cannot change this by rule, and its inclusion in Rule 31 would be inappropriate.

The proposed rule also expands the area of representation beyond appearing in small claims court and includes communicating with homeowners regarding unpaid assessments and fees. So long as this communication does not include an expression of legal opinion or otherwise affect or secure legal rights for a specific person or entity, the communication is not the practice of law and does not require an exemption under Rule 31. *See* Rules 31(a)(2)(A)(1) and (2). If the communication is intended to include the expression of legal opinions or otherwise affect or secure legal rights for a specific person or entity, then it is beyond the scope of the other exemptions contained in Rule 31(d) and would set a dangerous precedent. The exemptions generally provide for limited representation in particular settings, not giving legal advice or otherwise affecting or securing legal rights for a specific person or entity.

The proposal cites Section 116.540(i) of the California Code of Civil Procedure in support of the proposed exemption. It accurately quotes the California provision, which permits an agent, management company representative or bookkeeper to appear in small claims court on behalf of an HOA (but does not permit any of those entities to provide legal opinions to homeowners, draft liens, or execute liens on behalf of the HOA, as does the proposed exemption). However, Cal. Code Civ. Proc. Section 116.540(j) also requires that when one of these parties appears and participates in a small claims action on behalf of an HOA, the party must provide a declaration to the small claims court stating: (1) that the individual is authorized to appear on behalf of the party; (2) the basis for that authorization; and (3) that the individual is not employed solely to represent the party in small claims court. The provisions of subsection (j) are similar to the requirements in the other exemptions to Arizona's Rule 31(d) that permit an officer of a corporation or

managing member of a limited liability company to represent that entity (in this case, the HOA) as long as it is not his/her primary duty and/or he or she is not paid.

D. The proposed amendment is inconsistent with small claims statutes.

The proposal sets up a false dichotomy: associations pay attorneys lots of money, or pay community association managers little money, to bring suit in small claims court for unpaid assessments. Under existing law – specifically, ARIZ. REV. STAT. § 22-512, neither an attorney nor an employee of a property management company can bring an action on behalf of an HOA in small claims court. Moreover, attorneys' fees, if any, are passed on to the delinquent homeowner pursuant to the CC&Rs, which may not be the case for a community association manager, depending on the CC&Rs.

The proposal also improperly argues that a director may have very little knowledge of a delinquent owner's account. It would be improper for any party, whether officer, director, employee or community association manager, to bring suit or take other collection action against a delinquent homeowner without proper authorization from the Board. Petitioners' argument is without merit.

II. Liens

Arizona law currently permits an association to record a lien affecting real property. *See* ARIZ. REV. STAT. § 33-421. This statute does not provide that an HOA management company or third party may effectuate the lien, but rather that the entity created under the CC&Rs may do so. *Id.* Again, an HOA management company can easily have authority to act for the association in recording such liens by simply becoming an officer of such entity.

However, the record in this matter also needs to be clarified concerning the myriad legal complications and laws that currently regulate association liens.

Association liens for assessments are already created and exist by statute from the time the assessment becomes due. ARIZ. REV. STAT. §33-1807 (planned communities) and § 33-1256 (condominiums). Contrary to what the petition states, these statutes do *not* permit the recording of additional liens, but instead only provide that certain assessments are automatically considered liens from the date they become due. *Id.* Frankly, these statutes negate the need to record any further liens pursuant to the apparent authority established under § 33-421.

More importantly, the association assessment lien laws were revised in 2006 (subsequent to the revisions permitting associations to record liens under § 33-421) to provide that impositions of *late payments, monetary penalties and fines for CC&R violations* under § 33-1803 or § 33-1242, as applicable, are *not* automatic assessment liens and cannot be foreclosed and that a lien for such restricted items can be effectuated *only* by obtaining a civil judgment *from a court of competent jurisdiction* and recording that judgment. *See* ARIZ. REV. STAT. § 421(A); *see generally* ARIZ. REV. STAT. §§ 33-1803 and 33-1242 (emphasis added).

Thus, if any lien is recorded by an association pursuant to § 33-421, and to the extent such lien reflects any late payments, monetary penalties and fines identified in either § 33-1803 or § 33-1242, as applicable, those items cannot be liens against the real property in question without civil suit and are violative of the specific provisions of the association lien statutes. Furthermore, the association may not foreclose on such § 33-1803 or § 33-1242 judgment liens and is instead required to await conveyance of any interest in the real property to collect such sums. *Id.* These provisions would appear to prohibit collection of such sums by any other means, including a personal suit, garnishment or any other execution or levy methods. Moreover, in that neither justice courts nor small claims courts have jurisdiction to hear matters affecting title to real property (and such restricted

association judgment liens arguably do ultimately affect title to real property), any such action to enforce a claim for late payments, monetary penalties and fines under §33-1803 or § 33-1242 would, by definition, need to be brought in the superior court. *See* ARIZ. REV. STAT. § 22.201(D).

Given the complexity of the existing lien statutes and the myriad legal complications thereunder, it would be imprudent and to the extreme detriment of homeowners to permit unlicensed laypersons to litigate, file questionable liens, or otherwise attempt to collect such assessments for the benefit of associations and to cloud title to a homeowner's lot or affect their credit without advice from counsel. These actions require the knowledge and expertise of a competent attorney. To do otherwise would undeniably cause hardship to homeowners who do not have the financial wherewithal to fight and protect against any such illegitimate liens or small claims actions.

III. Homeowner Association Management Companies Are Not Regulated.

There are no specific provisions in the Arizona statutes for regulation and governance of HOA management companies. These organizations represent hundreds of associations, they assess and collect huge sums of money from homeowners, they hold millions of dollars' worth of assessment and reserve payments for the benefit of the associations and their members, and they oversee and manage real property and common areas owned or controlled by the associations. For all of this, they are amply compensated.

In Arizona, one of the petitioners, the Arizona Association of Community Managers, is a discretionary agency that educates and certifies HOA management companies. However, this organization is neither regulated nor controlled by the State of Arizona or any other regulating agency. Moreover, while this attempt at self-regulation is laudable, there is no requirement for an HOA management

company to be a member of this organization or to undertake the training and certification services it proffers.

Many of the functions that an HOA management company performs are similar to those that a real property manager might undertake on behalf of a landlord. In reality, however, HOA management involves much, much more. Like real property managers, HOA management companies oversee the operation, maintenance and management of common areas, roads and common facilities. They also attempt to enforce CC&R compliance in the same manner in which real property managers enforce leases, but real property managers must do so through counsel. And, perhaps most importantly, they collect assessments and maintain reserve accounts which can amount to thousands, even millions, of dollars depending on the size the association, and collect fees for these services just like real property managers do, but with regulated accountings and more individualized control by a single landlord. Under Arizona law, however, real property managers are required to be licensed. ARIZ. REV. STAT. § 32-2122. Interestingly, the petition goes so far as to admit that associations play many of the same roles that municipal governments do; yet even municipal governments are regulated.

Furthermore, arguably under Arizona law HOA management companies should be categorized as "collection agencies" and should at least be required to be licensed pursuant to the rules promulgated under ARIZ. REV. STAT. §§ 32-1000 *et seq.* Clearly, HOA management companies fall under the definition of a "collection agency," as they regularly undertake efforts on behalf of HOAs to solicit "claims" for collection of amounts owed, due, or asserted to be owed or due to the HOAs. ARIZ. REV. STAT. § 32-1001(2)(a). Moreover, the "claims" they make for payment of assessments, late penalties, fines, etc., are the same as those contemplated in the statutes. ARIZ. REV. STAT. § 32-1001(1). The petition seeks to permit the HOA

management companies to "communicate with homeowners and condominium unit owners about unpaid assessments and fees," which is just another way of soliciting claims as addressed in the collection agency statutes. Furthermore, the small claims actions in which they are seeking to represent associations are obviously geared to further their unregulated reach in such collection activities. However, there is not one HOA management company (listed in the Tucson phone directory) that is licensed as a collection agency with the Arizona Department of Financial Institutions. *See* Arizona Department of Financial Institutions website at http://azdfi.gov/Lists/CA_List.HTML.

In that HOA management companies are technically "collection agencies," they are prohibited by state law from sending to any debtor a notice, letter, message or form which simulates any legal process. ARIZ. REV. STAT. § 32-1051(5)(a). This clearly controverts the proposed Rule 31(d) amendment. If licensed, bonded and regulated collection agencies or real property managers may not pursue collection or bring action on behalf of creditors, it flies in the face of reasonableness to permit unlicensed, unregulated HOA management companies, which control the assessment and collection of millions of homeowners' dollars, to do so.

IV. Duty to HOA and Members

Unless specifically established pursuant to the terms of a management agreement, an HOA management company owes no duty, fiduciary or otherwise, to an association or its members. By instead requiring a manager to become an officer of the HOA as a condition of representing it in a justice court or small claims court action, he or she would at least have a responsibility to act in good faith and with the care of a prudent person as against the corporation and third parties. ARIZ. REV. STAT. § 10-3842. Unless the HOA management company is an officer of the association, there also exists a potential lack-of-privity defense to any rightful claim

that a homeowner might have against them for their illegitimate actions, for which the association would probably and ultimately be liable, again to the detriment of homeowners.

Obviously, the associations themselves and attorneys have direct exposure for their illegitimate actions under law. Unlicensed and unregulated management companies should not be given such an unreasonable and unconscionable loophole as is proposed by the petition.

V. Comparison of Petitioners' Proposal to UPL Advisory Opinion #04-02

Although they did not mention it in their original petition, it is anticipated that petitioners will refer to UPL Advisory Opinion #04-02 as support for their rule change proposal. UPL Advisory Opinion #04-02 concerned the activities of property management companies, including preparation of notices and demand letters to homeowners, preparation and recording of liens, and participation in legal proceedings regarding unpaid rent and assessments. The opinion states that it is "advisory in nature only and not binding in any disciplinary or other legal proceedings."

Unlike the proposed rule, the opinion does not suggest that an employee of a management company may execute a notice of lien against real property on behalf of a client homeowners association.

Another difference between the opinion and the proposal is that the opinion does not suggest that a property management employee may negotiate with a property owner concerning legal issues, such as unpaid assessments and fees. It would be logical to anticipate that such negotiations would extend to dictating the terms and conditions of the owner's right to remain in the premises following default, setting payment terms to cure a delinquency, settling or forgiving disputed charges, or discussing the validity of the legal process.

Also unlike the proposed rule, the opinion does not suggest that an employee of a management company may represent an HOA in legal proceedings. On the contrary, the opinion specifies that a property management company employee may not represent an HOA in a legal proceeding. In the opinion, the question and answer refer to a mediation, whereas the proposal refers to small claims procedures. It is clear, however, that the opinion does not support the petition in any of these respects.

The opinion provided that under certain circumstances, a management company employee may prepare legal documents, such as eviction notices and notices of breach, citing a provision in Rule 31 currently numbered Rule 31(d)(20). That exception to Rule 31(b) says:

> Nothing in these rules shall prohibit the preparation of documents incidental to a regular course of business when the documents are for the use of the business and not made available to third parties.

The opinion acknowledged that this exception "could technically be read" to assert that it does not apply, "because the management company was preparing the documents for use by a 'third party' – the owner of the property." However, it went on to say:

> The more appropriate reading of Rule 31, from a public policy perspective, would appear to be that the document is being prepared by the management company and used by the management company in a manner that is incidental to the regular course of its business.
>
> Therefore a management company with broad responsibilities regarding management of a property or management of an association may prepare legal documents that are incidental to the management of the property (just as the owner would be allowed to do so) pursuant to [Rule 31(d)(20)].

This reasoning is currently under review by the UPL Committee, not only to study its validity in the opinion, but also to see if it can be harmonized with recent

decisions of the "various administrative bodies" referred to in the petition and in the comment filed by the Board of Legal Document Preparers. These bodies "have found that a community management company's execution of a lien in an association's behalf constitutes the unauthorized practice of law." In the meantime, it is pertinent to note that if the petition in either form is rejected, the guidance in the opinion will remain unaffected.

VI. Petitioner's "Compromise" Language

On June 3, 2011, petitioners filed a comment to their Rule 28 petition proposing a "compromise" that would limit their rule change proposal to only allowing condominium unit owners' associations and planned community associations to be represented by employees and officers of property management corporations who are not members of the State Bar in the preparation, execution and recordation of notices of liens created pursuant to A.R.S. § 33-1256 and § 33-1807 if the management company has a contract with a management association that gives the property management company the primary responsibility for the management of the association. *See* Petitioner's Compromise Language for Petition to Amend Rule 31(d), Arizona Rules of the Supreme Court, Appendix A. While petitioners have discussed their petition and, to a lesser extent, their "compromise" with the Board of Governors and various committees of the State Bar, the State Bar is unaware of any stakeholders who have in fact "compromised" their position regarding the petitioners' request. Thus, petitioners' "compromise" is more of an alternative petition than any compromise.

The State Bar acknowledges that the petitioners' "compromise" removes some of the objectionable provisions of the original petition. Nonetheless, the Bar continues to oppose the provisions that remain in the so-called "compromise." These remaining provisions are virtually unchanged from the original petition and

remain as objectionable after the "compromise" as they were in the original petition for all of the same reasons previously set forth in this comment. The only real difference between these provisions in the "compromise" and the same provisions in the original petition is that the petitioners have added the language "if the management company has a contract with the association that gives the management company primary responsibility for the management of the association" to the provisions.

In 2003, during the time when the Supreme Court was considering revisions to Rule 31, Ariz. R. Sup. Ct., addressing the definition of the practice of law and the unauthorized practice of law, non-lawyer legal document preparers actually picketed the Court, demanding to be allowed to continue to provide services. In response, the Court instituted the Legal Document Preparer Program, codified in the Arizona Code of Judicial Administration (ACJA) at § 7-208. In particular, ACJA § 7-208(C) expressly reflects the Court's desire to protect the public from possible harm caused by non-lawyers by establishing performance and ethical standards for non-lawyers and business entities as a condition of providing legal document preparation services to individuals and business entities. Petitioner AAM, LLC, is reportedly an HOA management company. The company is aware that drafting legal documents is the practice of law and therefore cannot be performed by non-lawyers, except as provided by rule. To perform the function of drafting legal documents, the company employs one or more certified Legal Document Preparers (LDPs) who are certified by the Supreme Court's Legal Document Preparer Program. This is entirely acceptable. ACJA § 7-208(F)(1) provides specified, authorized services that a certified Legal Document Preparer may provide to consumers. No provision of ACJA § 7-201 or § 7-208 authorizes a

certified Legal Document Preparer to act in a representative capacity on behalf of a customer, including signing documents for a customer.

About a year ago, it came to the attention of the LDP Board that about a dozen certified LDPs were providing representative services to an HOA, including the signing of notices of lien. In response to the Board's investigation and prospective action against them, seven admitted wrongdoing and entered into consent agreements. Similar arrangements have been offered to four others. Only petitioner AAM, LLC, has declined to accept a consent agreement; and an order of probable cause has been filed against it. AAM, LLC has been engaged in this effort to render the certified Legal Document Preparer rules inapplicable to them by seeking this amendment to Rule 31, Ariz. R. Sup. Ct.

The adoption of petitioners' June 3, 2011, comment will expose homeowners to possible harm from unregulated HOA management companies who cannot be held accountable for the legal services they provide. Further, adoption of the proposal will set a dangerous precedent and open the door for other non-lawyers who offer specialized legal services to seek similar exceptions tailored to circumvent regulatory oversight and accountability.

CONCLUSION

The State Bar of Arizona respectfully requests that the Court deny petitioner's proposed rule amendment, in both its original and its revised form.

RESPECTFULLY SUBMITTED this 17th day of June, 2011.

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Electronic copy filed with the Clerk
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this 20th day of June, 2011,

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