
Sunset Evaluation Report: Time Sharing

A Report to the
Governor
and the
Legislature of
the State of
Hawai'i

Report No. 92-19
November 1992



THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Sunset Evaluation Report: Time Sharing

Summary

We evaluated the regulation of time share plans under Chapter 514E, Hawaii Revised Statutes, and conclude that the public interest is best served by reenactment of the statute.

Time share plans divide units of real estate, generally condominium apartments, into 52 one-week segments that are sold separately. Buyers receive an exclusive right to occupy the unit for a recurring period of time, usually one to four weeks each year. Sellers claim that time sharing provides the advantages of a vacation home without the high cost and protects future vacations from inflation.

Time share marketing depends heavily on getting prospective buyers to attend sales presentations. Gifts or discounts are typically offered as an inducement. Prospective purchasers are often solicited from booths located in hotel and resort areas.

Hawaii began to regulate the time share industry in 1980. We found that since then, the Department of Commerce and Consumer Affairs has carried out an efficient registration program covering plan developers, sales agents, and others. There are strict disclosure requirements to let consumers know what they are getting into. Expert consultants review all documents filed by developers.

As a result, buyers of time share properties have received protection against foreclosures on their units and misrepresentation by developers and salespersons. The department's Regulated Industries Complaints Office (RICO) has enforced the time share law by helping buyers to obtain titles, refunds, and other promised services.

For these reasons, we believe the regulatory program should be continued with several improvements to address recent problems. In particular, time share owners increasingly have run into difficulties with the management of time share plans. Because owners are geographically dispersed and spend only a short time each year in their units, they need strong protection from management abuses such as exorbitant increases in maintenance fees and unexpected special assessments. The current time share law is designed to protect buyers from abuses in sales practices but offers insufficient protection from management abuses. Furthermore, most time share units are located in

condominium projects, but it is not clear whether the units are covered by the management provisions in the state's condominium law.

We also found that the department's administrative rules go beyond the statute by adding new registrants and by attempting to regulate conduct too broadly. In addition, members of the time share industry disagree constantly with the time share administrator as to how the disclosure rules for time share promotional material should be applied. Moreover, the department has not yet implemented its new booth location form, and it has not issued the required annual report on the time sharing program since 1986.

Recommendations and Response

We recommend that Chapter 514E be reenacted to continue the regulation of time sharing. To increase the protections for consumers, the Legislature should consider amending the law to strengthen controls over plan management. The law could require management to (a) adopt and distribute an annual operating budget, including proper disclosure of reserves and (b) submit to the Department of Commerce and Consumer Affairs an annual independent financial audit of the plan. In addition, time share owners could be authorized to discharge unresponsive plan managers. The director of commerce and consumer affairs should explore alternatives to the bond required of plan managers and propose legislation to clarify the relationship between the time share law and the condominium law.

We also recommend that the department clarify the rules regarding disclosures on time share promotional materials. It should repeal the section of the rules entitled Conduct and the provisions requiring registration of the employees and independent contractors of acquisition agents and sales agents. The department should implement its revised booth location form and include a report on the time share program as part of its annual report to the Legislature.

The department agrees that Chapter 514E should be reenacted and amended to address emerging problems in plan management. In addition, the department agrees to review the relationship between the time share and condominium laws, to clarify the rules on promotional materials, and to implement a revised booth location form. The department believes it has the authority to retain the section of the rules entitled Conduct and the provisions requiring registration of sales agent employees or independent contractors who work for sales agents and outside public contacts (OPCs) who work for acquisition or sales agents. Nevertheless, it does agree to discontinue the registration of OPCs. Finally, the department believes that its annual report to the Legislature meets the requirement of an annual report on time sharing.

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Submitted by

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STATE OF HAWAII

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Foreword

The Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, schedules regulatory programs for termination on a periodic cycle. Unless specifically reestablished by the Legislature, the programs are repealed. The State Auditor is responsible for evaluating each program for the Legislature prior to the date of repeal.

This report evaluates the regulation of time sharing under Chapter 514E, Hawaii Revised Statutes. It presents our findings as to whether the program complies with policies in the Sunset Law and whether there is a reasonable need to regulate time sharing to protect the health, safety, and welfare of the public. It includes our recommendation on whether the program should be continued, modified, or repealed. In accordance with Section 26H-5, HRS, the report incorporates in Appendix B the draft legislation intended to improve the regulatory program.

We acknowledge the cooperation of the Department of Commerce and Consumer Affairs, representatives of the time share industry, and others whom we contacted during the course of our evaluation. We appreciate the assistance of the Legislative Reference Bureau, which drafted the recommended legislation.

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State Auditor

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Chapter 1

Introduction

The Sunset Law, or the Hawaii Regulatory Licensing Reform Act, Chapter 26H, Hawaii Revised Statutes, establishes policies for occupational licensing and schedules the repeal of licensing statutes according to a timetable. The law directs the State Auditor to evaluate each licensing statute prior to the repeal date and to determine whether the health, safety, and welfare of the public are best served by reenactment, modification, or repeal.

This report evaluates whether the regulation of time share plans under Chapter 514E, HRS, complies with policies for occupational regulation in the Sunset Law.

Background on Time Sharing

Time sharing gives a purchaser the right to occupy a unit of real estate, generally a resort condominium, for a given period of time. The calendar year is usually divided into 52 one-week blocks which are sold separately. Each purchaser obtains the exclusive right to occupy the unit for a recurring term, commonly one to four weeks each year.

A time share plan may encompass part of a resort property, an entire resort, or multiple resorts throughout the world. Buyers generally purchase one of two types of plans: (1) an "ownership" plan where they receive fee interest (title) in the property; or (2) a "use" plan where they receive a long-term lease (as long as 50 or 60 years), membership, or other arrangement short of ownership.

The time share industry

Time sharing began in Europe in the early 1960s. It spread to the United States in the 1970s and was spurred by a real estate slump which left an excess of vacant resort condominiums on the market. This was the situation in Waikiki. Sellers promoted time share plans by claiming that they saved money, ensured predictable accommodations, and protected future vacations from inflation.

Worldwide, time share sales reached over \$3 billion in 1991.¹ The states reporting the most time share resort units (existing and under construction) were Florida, Nevada, California, Texas, Hawaii, and Colorado.²

Currently, about 25 plan developers are selling in Hawaii. Since 1981, there have been about 112 registered time share plans.³ Mergers, transfers, and dissolutions have occurred among these plans to alter their

number over the past 12 years. Today there are around 61 time share projects in Hawaii: 7 on Hawaii, 16 on Kauai, 23 on Maui, 1 on Molokai, and 14 on Oahu.⁴

Typically, a developer creates a time share plan and puts together a sales and management group. The group generally consists of an acquisition agent, a sales agent, and a plan manager. All three are usually corporations. The acquisition agent employs outside public contacts (OPCs) to invite prospective buyers to sales presentations. The sales agent employs salespeople to make presentations to sell the plan. And the plan manager provides management services for the time share property.

In Hawaii, OPCs work out of booths located in hotel and resort areas. They offer incentives such as free dinner cruises or discounted tours to encourage visitors to attend a time share sales presentation. Developers also offer discounted resort accommodations to prospective buyers for attending a presentation. At the presentation, which may last an hour or two or longer, a team of salespersons attempt to sell the plan. Most time share sales occur at these presentations.

Others in the time share industry include exchange agents who help people swap their time share rights and resale agents who help people resell their time share interests. Currently, the supply of time share resales far exceeds the demand.

Regulation of Time Sharing

Hawaii first regulated time sharing through Act 186 of 1980 to control “the creation, operation, marketing, and role of time share programs in Hawaii.”⁵

The growth of time sharing had been controversial. Those in favor of the industry believed that time sharing would stimulate Hawaii’s economy. But others saw problems such as the adverse impact of high-pressure sales tactics upon visitors and the disruption from introducing time share units into existing residential condominiums. Rather than banning time sharing, the Legislature enacted strict regulation.

Act 186 sought to “reduce the actual and perceived problems of time sharing without unduly retarding the industry.”⁶ It required developers, sales agents, acquisition agents, and plan managers to register with the Department of Commerce and Consumer Affairs. It established bonding and disclosure requirements, prohibited soliciting on public property, required time share promotions to be identified as such, and allowed the purchaser or the seller of a time share interest to rescind (cancel) the contract within five days. The new law also gave condominium

residents more control over the introduction of time share units and permitted higher maintenance charges for those units because of the expected additional wear and tear.

The Legislature has amended the law several times in response to continued complaints about the high-pressure sales tactics of time share salespeople, the negative impact of these sales tactics on tourism (particularly in Waikiki), the bankruptcy of one of Hawaii's largest time share organizations with 3,000 members, and heavy workload demands on the regulatory program. The amendments provided for tougher disclosure and bonding requirements, stricter control over sales practices, a seven-day cancellation period, cease-and-desist orders, protection of purchasers from liens, the hiring of a time share administrator, and consultant review of developer filings.⁷

The current time share program is governed by Chapter 514E, HRS. The law applies to "any plan or program in which the use, occupancy, or possession of one or more time share units circulates among various persons for less than a 60-day period in any year, for any occupant."⁸ It covers both ownership plans and use plans. Time share transactions constitute the offer and sale of real property under Chapter 467, HRS, which regulates real estate brokers and salespersons.

A time share administrator in the Department of Commerce and Consumer Affairs carries out the registration, disclosure, and purchaser protection requirements and is responsible for the duties conferred by law upon the director of commerce and consumer affairs. The department's Regulated Industries Complaints Office mediates and resolves consumer complaints, pursues disciplinary action against registrants, and seeks court injunctions and fines against unregistered persons. Final disciplinary decisions are made by the director following a recommended decision from the department's Office of Administrative Hearings.

Plan developers

The regulatory process begins when developers register by filing their time share plan and a detailed disclosure statement. The disclosure statement must describe the units being offered; the type of plan; the seven-day cancellation period; any defects or encumbrances affecting the property; and the total financial obligation of the purchaser, including an estimate of dues, maintenance fees, and taxes, among other items.

The plan must be approved by the director before it can be offered to the public. The law permits the director to contract with private consultants to review these complex developer filings and to provide a written opinion as to their legal compliance. The department draws upon a pool of three consultants for this purpose. Developers must pay for the consultant review which may run into several thousand dollars.

Other registrants

Acquisition agents, sales agents, plan managers, and exchange agents must also register. They must identify the time share plan with which they are affiliated and their responsible managing employee where applicable.

Among other requirements, acquisition agents must either be bonded or be licensed real estate brokers or salespersons covered by the real estate recovery fund under Chapter 467, HRS. Sales agents must be licensed real estate brokers or salespersons covered by the recovery fund and must set up an escrow account for the deposit and collection of purchasers' funds. Plan managers must be bonded but need not be licensed under the real estate law.

Resale agents, sales agent employees or independent contractors, and OPCs must also register and pay fees.

Promotions and sales

Promotional literature and other printed material must be filed with the director prior to use. Such material must state in large print that it is a time share sales presentation and notify potential purchasers of the seven-day right of rescission (right to cancel).

OPCs, generally working in booths located in hotel and resort areas, must be employed by time share acquisition agents or sales agents. OPCs may only invite people to attend a time share presentation; questions about plans must be answered by a licensed real estate broker or salesperson. OPCs may distribute handbills outside the booth but must be inside it or in a broker's place of business when signing people up for presentations and when handling money.

Buyers' funds must be held in escrow until the expiration of the seven-day cancellation period and may be released only when the developer satisfies certain requirements to protect buyers from blanket liens. These include conveying the funds to a lien payment trust, filing a nondisturbance agreement, recording a surety bond or irrevocable letter of credit, and filing a notice of time share plan.

Enforcement

The time share law contains an extensive list of prohibited, unfair, and deceptive practices. For example, offering gifts and prizes to encourage consumers to attend sales presentations without clearly disclosing the conditions is a violation of the law. Other violations include receiving payment from a purchaser before a contract is signed, failing to inform the purchaser of the seven-day right of cancellation, and failing to honor an attempt to cancel.

The director may sue to enjoin violations of the law, issue temporary cease-and-desist orders where delay would irreparably harm the public interest, fine registrants up to \$10,000 for each offense, and suspend or revoke registrations. Time share purchasers may void any sale made in violation of the law and may go to court to get their money back.

Objectives of the Evaluation

This evaluation sought to determine whether the regulation of time share plans complies with policies in the Sunset Law. Specifically, the objectives were to:

1. Determine whether there is a reasonable need to regulate time sharing to protect the health, safety, and welfare of the public;
 2. Determine whether current regulatory requirements are appropriate for protecting the public;
 3. Establish whether the regulatory program is being implemented effectively and efficiently; and
 4. Make recommendations based on findings in these areas.
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Scope and Methodology

To accomplish these objectives, we reviewed the literature and statutes and rules on time sharing. We also reviewed evidence of harm to consumers and complaints. We interviewed personnel from the Department of Commerce and Consumer Affairs, representatives of the time share industry, consultants to the time share program, and other knowledgeable persons. At the department, we reviewed files on regulatory operations, licensing, and correspondence. We attended time share presentations to observe sales practices and examined advertising and promotional material.

Our work was performed from May 1992 through September 1992 in accordance with generally accepted government auditing standards.

Chapter 2

Findings and Recommendations

We recommend that time share plans continue to be regulated. The regulatory program in the Department of Commerce and Consumer Affairs has helped to protect consumers from harm. In this chapter we recommend some improvements in the statutes, the rules, and the administration of the program.

Summary of Findings

1. The State should continue regulating time share plans to protect the public's welfare.
2. The requirements for time share promotional material are burdensome and unclear.
3. The administrative rules go beyond the statute in the regulation of conduct and in the requirements to register.
4. The relationship of the time share law to the condominium law is unclear.
5. Stronger regulation of the management of time share plans is appropriate.
6. The department could improve its effectiveness by better monitoring time share booths and by issuing annual reports to the Legislature.

State Should Continue To Regulate Time Sharing

Chapter 514E should be reenacted to continue the regulation of time share plans. Time sharing has caused harm to the public in the form of financial loss, property loss, and undelivered services. Regulation has helped to protect consumers. Most states have some form of time share legislation. Some states, such as Florida, have very comprehensive legislation that includes requirements for disclosure, rescission, licensing, escrow, advertising, and plan management.

Evidence of harm

Substantial harm has been done to time share purchasers in the past decade. The department has taken a variety of actions to help consumers.

Civil lawsuits affecting large groups of consumers made news from 1981 to 1987. In 1981 one of Hawaii's largest time share organizations went into bankruptcy. The developer had failed to pay off liens and had left up to 3,000 buyers without a place to stay. The department sued the club for unfair and deceptive trade practices. Under the settlement agreement with the department, the developer had to leave the time share business.

In 1986 another developer failed to make timely payments to a consumer under an administrative order issued by the department. Although the department revoked the developer's registration, the developer sold another 123 time share units in violation of the time share law and failed to make prompt refunds to purchasers who had cancelled. As a result of a suit by the department, the developer was prohibited from selling time share plans, was fined \$500,000, and agreed to refund a total of more than \$40,000 to 18 consumers.

In 1987 another developer declared bankruptcy. The developer and its plan manager had used the maintenance fees from owners for their own purposes. Hundreds of owners had to make substantial cash contributions to make up for the misappropriated maintenance fees. Some lost the use of their vacation accommodations altogether. The department and the attorney general sued the developer and the plan manager for unregistered activity and unfair and deceptive trade practices. Eventually the developer stopped selling time share in Hawaii and left the state.

These lawsuits did not always result in full refunds for buyers, but they prevented the developers from making further sales.

Complaints

The volume of complaints continues to be substantial. In 1991, 71 time share complaints were filed with the Regulated Industries Complaints Office (RICO); through June 4, 1992, another 36 were filed. These figures were up slightly from 1990, when 65 complaints were filed.

In the past two years, many of the complaints concerned advertising violations and were initiated either by department staff or members of the industry. Consumer complaints more often concerned one of the following: failure to make refunds; failure to provide title; unfair or deceptive trade practices; dishonest, fraudulent, or deceitful acts; and misrepresentation.

In 1991, seven cases alleged failure to make refunds. The department resolved five cases in which the buyers received refunds, sent an advisory letter and obtained a refund in the sixth case, and found insufficient evidence in the seventh case.

Regulation of time sharing in Hawaii appears to have protected the public through both prevention and enforcement. The department's time share office is carrying out an efficient registration program with strict disclosure requirements, protection from blanket liens, and consultant review of developer filings. These preventive measures seem to have put an end to the major time share civil cases of the past. At the same time, the department's enforcement program has helped consumers to avoid losing money and property. RICO has helped buyers to obtain refunds, titles, and other promised services. For these reasons, we believe that the regulatory program should be continued.

Requirements for Promotional Material Are Unclear

The time share industry and the time share office do not agree on how the rules on promotional material should be interpreted. The rules require all advertising and promotional material to be filed with the director at least fifteen days prior to use.¹ This is to insure that a time share disclosure caption is included on all promotional literature and other printed material used in connection with the sale of time share plans. The caption must be in capital letters in large bold type and read as follows:²

**THIS IS A TIME SHARING SALES PRESENTATION.
ANY PURCHASER HAS, UNDER THE LAW, A SEVEN-
DAY RIGHT OF RESCISSION OF ANY TIME SHARING
SALES CONTRACT.**

The disclosure is intended to inform prospective buyers that gifts and discounted activities are related to time share sales. It also notifies buyers of their right to cancel the contract within seven days.

Time share industry members have complained that the department is interpreting the rules too strictly by requiring the caption (1) on all signs containing prices or descriptive language, and (2) on every page of a multi-page unit of time share literature. The department will not allow stamps and stickers to be used for this purpose.

In a letter to the real property section of the Hawaii State Bar Association, the time share administrator explained the reasons for these interpretations: (1) a sign, if promotional, comes under the definition of the rules and must include the disclosure; (2) a multi-page promotional unit must contain the disclosure statement on every page so that if the pages are distributed separately, the consumer will still know that time sharing is involved in the offer; and (3) the use of stamps and stickers is unacceptable because they increase the likelihood that promotional material will be distributed without the disclosure statement.³

We feel that requiring the disclosure statement on every page of a multi-page unit is excessive. The number of letters and reports written by developers, their attorneys, and the time share administrator indicate that this is a major issue. We recommend that the rules be clarified regarding disclosure on promotional material. They should be sufficiently clear so that there is no question about how they are interpreted by developers, current administrators, or future administrators.

In amending the rules, the department should wait for an opinion from the attorney general who is currently examining the constitutionality of requiring the disclosure statement on signs. The department should also specify that sales materials that comprise one document require only one disclosure caption.

Finally, we agree that the use of stamps and stickers increases the possibility that the disclosure statement would not appear on sales material. Stamps may be uneven or smeared or too light to provide the required time share notice, and stickers may be inadvertently left off or removed from the sales material. Therefore, we recommend that the rules specify that a printed disclosure caption must be on all promotional literature.

Rules Go Beyond the Statute

The department has adopted rules that go beyond the time share statute in two important respects. First, they regulate the conduct of registrants too broadly. Second, they expand the categories of registrants.

Vague standards on conduct

Section 16-106-2.5 is titled simply Conduct. It requires registrants to follow certain standards in the conduct of their business. These standards are vague and unenforceable. One of the standards reads as follows:

The registrant shall protect the public against fraud, misrepresentation, or unethical practices in the time share industry. The registrant shall endeavor to eliminate any practices in the community which could be damaging to the public or to the dignity and integrity of the time share industry. The registrant shall assist the director in its efforts to regulate the practices of the time share industry in this state.

Failure to meet this standard can result in loss of registration.

We believe this standard is overbroad and vague. We found no indication that the department has taken any actions based on this rule. We believe it should be repealed.

Additional categories of registrants

The rules add new categories of registrants not covered in the statute: (1) sales agent employees or independent contractors who work for sales agents and (2) outside public contacts (OPCs) who work for acquisition or sales agents.⁴

The stated purpose for registering sales agent employees or independent contractors and OPCs is to keep out the dishonest ones. High-pressure sales tactics and misrepresentation by salespersons and OPCs are a big problem in the time share industry. These people usually are paid on commission with no base salary or benefits. More than one expert on time sharing has said that large up-front sales commissions can lead to problems with sales practices.

However, the statute does not authorize their registration and the requirement should be removed from the rules. We note that the rules already require acquisition and sales agents to file with the department the names of all their employees and independent contractors who solicit and sell time share plans. They must also furnish evidence that their salespersons have real estate licenses.⁵ If additional protection is needed, the law could be amended to make the acquisition agent or sales agent responsible for the acts of their employees or independent contractors.

Time Share Law Does Not Specify When Condominium Law Applies

It is not clear when the condominium law (Chapter 514A) applies and when the time share law (Chapter 514E) applies. This issue needs to be clarified because in Hawaii, most, if not all, time share plans are located in condominium projects. As more and more time share projects are sold out and consumers are faced with management concerns, the applicability of the condominium law will doubtless come more into question, particularly with respect to time share associations' budgets and reserves.

Confusion already has occurred with regard to cancellation periods. Time share buyers in new condominium projects receive two public documents: the condominium report with a 30-day cancellation notice and the time share report with a 7-day cancellation notice. Buyers could be misled and harmed if they were to assume they had 30 days to cancel when they only had 7 days.

The time share administrator has reported that buyers are confused about this issue, and the executive secretary of the Real Estate Commission said the matter has been discussed at meetings of the National Association of Real Estate Licensing Law Officials. He felt that the 30-day period in the condominium law would prevail, but he said the law is not clear.

In a legal case on a different issue, the time share law prevailed. The question was whether to follow the condominium law, which requires a minimum 75 percent vote of unit owners to authorize time sharing, or to follow the time share law, which requires a unanimous vote of unit owners. The Hawaii Supreme Court decided that the time share law prevailed.⁶

A RICO complaint in 1992 raised yet another question about the relationship between the two laws. A time share owner in a condominium project with both residential and time share units complained that the scheduling of maintenance activity by the condominium owners' association caused him to lose part of his vacation time. The condominium owners' association maintained that the problem belonged with the time share owners' association. RICO informed the complainant that while RICO has jurisdiction over condominium registration laws, those laws do not apply to time share owners' associations.

Hawaii may wish to follow Florida's lead in this matter. Florida has specified in the time share law that time share condominiums are subject to the provisions of both the condominium and the time share laws unless specifically exempted. In the event of a conflict, the provisions of the time share law take precedence.⁷ We recommend that the director meet with the time share administrator, the Real Estate Commission, and other appropriate officials to develop necessary legislation.

Plan Management Needs Stronger Regulation

Plan management is an emerging issue. The proper disclosure of management operations is crucial if the owners are to be protected from unexpected special assessments and exorbitant increases in yearly maintenance fees.

When the plan is sold out, developers often remain as managers, keeping control over the board and operations. They may continue to raise the management fees while neglecting to set aside funds for refurbishment or maintenance. When maintenance becomes absolutely necessary, the managers will call for a special assessment to cover the costs. The owners' costs would therefore continue to rise.

Since 1987, two large time share plans, each involving multiple properties in Hawaii, ran into financial difficulties through the mismanagement of owners' maintenance fees. The first declared bankruptcy; the second went into receivership. In both cases, the owners had to make substantial cash contributions to make up for lost reserves.

The time share office reports phone calls from time share owners worried that their plan managers may not be setting aside enough money for proper maintenance. RICO has also received complaints about inadequate maintenance. The enforcement officer of the Florida time share regulatory program told us that at one time, most complaints concerned high-pressure sales tactics and misrepresentation, but today, the largest number of complaints concern management problems. Three aspects of plan management need attention: (1) maintenance fees, (2) control of the plan manager, and (3) bonding requirements for plan managers.

Maintenance fees

New time share plans in Hawaii are managed by a plan manager under the control of the developer. Among other things the plan manager is responsible for assessing and collecting maintenance fees for the upkeep, repair, and operation of time share units. Once the plan is sold out, an owners' association may take over management or the developer may continue as manager, keeping control of the board and operations.

Plan management can be lucrative. A plan manager could receive \$17,500 per year in maintenance fees for a single one-bedroom unit. An industry survey in Hawaii reported the following average annual maintenance fees for a week in a time share (1/52 of the unit):⁸

Studio	-	\$ 273.06
One Bedroom	-	\$ 343.18
Two Bedroom	-	\$ 390.53
Three Bedroom	-	\$ 420.00

For two weeks the fees double, and so on. If a one-bedroom unit were occupied year-round except for one week set aside for repairs and maintenance, the plan manager would receive approximately \$17,500 per year in maintenance fees for the unit.

A performance audit of the time share regulatory program in Florida found owners to be unaware of the financial condition of their properties when they were managed by developer-controlled associations. Owners' associations that take over management sometimes discover that they do not have adequate reserves for operation and maintenance. The Florida report recommended that an annual independent audit of each time share plan be submitted to their division of land sales and condominiums for review.⁹

Currently, Hawaii's rules require plan managers to keep records of receipts and expenditures, which they must provide to time share owners and make available for inspection by the department.¹⁰ Because owners are geographically dispersed and only spend a short time each year in their time share units, they need greater protection from possible

management abuses. They need to know that their managing entity has a reasonable plan for maintaining and operating their units. Owners need assurance that their funds will not be diverted, that adequate reserves are kept, that their units will be maintained, and that their fees will be reasonable. Unexpected increases in annual maintenance fees have made time share units unaffordable for some owners, defeating their original purpose in buying a time share interest—to protect future vacations from rising costs.

A recent amendment to the Hawaii condominium law addresses the problem of adequate budgets and reserves. It requires the board of directors of each association of apartment owners to prepare an annual operating budget specifying (a) the estimated revenues and operating expenses, (b) the total cash reserves, (c) the estimated cash reserves needed to maintain property, and (d) the amount the association must collect to fund the reserves.¹¹

The provisions in the condominium law could be made to apply to time share plans. Alternatively, the time share law could be amended to include the following management provisions: (a) a requirement that management adopt an annual operating budget, including proper disclosure of reserves so that special assessments are not necessary; and (b) an annual independent audit of all books conducted by a certified public accountant in accordance with generally accepted auditing standards—a copy to be submitted to the department.

Plan managers

Some time share owners indicate that they lack control over plan managers. Owners have complained to the time share office that they cannot readily obtain the names of association members from their plan managers. As a result, owners find it difficult to win proxy wars and to alter the plan manager's control.

The rules require that managers must keep an accurate list of the names and addresses of association members so that time share owners may solicit votes or proxies.¹² However, this appears to be insufficient.

One expert has suggested that an annual vote of association members be required to approve plan managers and that automatic annual renewal provisions be prohibited in management contracts. Both Florida and California have time share laws that provide for discharging management.¹³ We believe that such a provision may be useful in Hawaii. The law could be amended to enable owners to discharge or retain plan managers through an annual vote of association members and allow the contract to be terminated by either party on not more than sixty days' written notice.

Plan manager bond

The plan manager bond is intended as a recovery fund for consumers in the event the plan manager or its employees fail to carry out their responsibilities.¹⁴ Plan managers have had difficulty obtaining a bond in the amount specified.

The director requires plan managers to file a bond equaling three times the total maintenance fees collected every 45 days or two times the total fees collected at intervals longer than 45 days. A cash bond or irrevocable letter of credit in the same amounts may be filed instead. There is a \$200,000 cap, and the director has the discretion to accept a bond or some equivalent. The cap and the discretionary authority were established in 1987 in response to complaints that the bonds were not available in the form and amounts required.

In 1990, the time share administrator found that the bonds for plan managers were unavailable at any cost unless the plan manager was a well-established company or had a very good relationship with its insurance company. Consequently, plan managers were posting fidelity bonds instead of surety bonds. (A fidelity bond will reimburse an employer for loss due to the dishonest acts of a covered employee. A surety bond guarantees that a principal will carry out specific obligations; it is most often issued to a person seeking licensing, a contractor, or someone involved in a court case.)

Experts in the time share industry suggest that the current bond may be too weak if the developer is managing the plan. It might not be enough to protect owners against the kind of losses they incurred in the past, such as the case in which the developer and plan manager diverted maintenance fees for their own use. But the bond may be more than sufficient if owners were in control of management.

Since the nature and amount of the required bond continue to be problematic, we recommend that the department consider trust accounts as an alternative. The bonding requirement for the plan manager could be substantially reduced if maintenance fees were deposited with a Hawaii-licensed trust company. A trust account could be established and maintained for the benefit of the time share owners. The plan manager would not be allowed to encumber the amounts in trust or withdraw money from the trust except in accordance with the trust agreement.

This would protect time share owners from the mishandling of maintenance reserves by plan managers of both developer-controlled and owner-controlled plans. The bonding requirement could be even further reduced if the owners took control of their time share projects.

Some Program Operations Can Be Improved

The department could improve the regulatory program by better monitoring time share booths and by issuing annual reports to the Legislature.

Monitoring of booths

The Maui County Planning Department expressed concern to the time share administrator that time share booths had been set up in violation of local ordinances on coastal zone management and historic districts. Part of the problem seems to stem from an inadequate form on "booth location" that must be filed with the time share office prior to setting up a booth.

Currently the form requires only the name of the company using the booth, the booth address, and a county official's approval of the zone. More information would be helpful, such as the name of the developer, the tax map key, the principal broker, the zoning of the booth site, and a plot plan. These revisions would assist the county planning departments in certifying that the booths meet state and county laws and the time share office in monitoring compliance. The previous time share administrator already has redrafted the form, and we recommend its implementation.

Annual report

Section 514E-13, HRS, requires the director to submit an annual report to the Legislature to keep legislators abreast of the progress of regulation of time sharing. A section on time sharing was included in the department's annual reports until 1986 and then discontinued.

We recommend that the department comply with Chapter 514E by including a section on time sharing in its annual report.

Recommendations

1. The Legislature should reenact Chapter 514E, Hawaii Revised Statutes, to continue the regulation of time share plans.
2. The Department of Commerce and Consumer Affairs should clarify the rules regarding disclosure on time share promotional material.
3. The Department of Commerce and Consumer Affairs should repeal Section 16-106-2.5 of the rules titled Conduct and the provisions requiring registration of the employees and independent contractors of acquisition and sales agents.

4. The director of commerce and consumer affairs should propose legislation to clarify the relationship between the time share law and the condominium law.
5. The Legislature should consider amending the time share law to authorize time share owners to discharge plan managers, to require management to adopt and distribute an annual operating budget, and to require an annual financial audit of the plan. The director should explore alternatives to the plan manager's bond such as requiring maintenance fees to be deposited with trust companies to reduce the bond.
6. The time share office should implement its revised booth location form. The department should include a section on the time share program in its annual report to the Legislature.

Notes

Chapter 1

1. Ragatz Associates, *An Annual Report of the World-Wide Resort Timesharing Industry, 1992*, The Alliance for Timeshare Excellence, American Resort Development Association (ARDA), Washington, D.C., 1992, p. 3.
2. Coopers & Lybrand, *Financial Performance in the Timeshare Industry*, International Foundation for Timesharing, ARDA, Washington, D.C., June 1992, p. 2.
3. Letter to Marva Stillians, Legislative Analyst, Office of the Auditor, from Sharon Matutino, Time Share Administrator, September 8, 1992.
4. Letter to Marva Stillians, Legislative Analyst, Office of the Auditor, from Richard L. Ragatz, President, Ragatz Associates, September 11, 1992.
5. Act 186, SLH 1980.
6. Conference Committee Report No. 37-80 on Senate Bill No. 1516, Regular Session of 1980.
7. Act 81, SLH 1981 (disclosure and stricter control over sales practices); Act 186, SLH 1982 (protection of purchasers from liens); Act 165, SLH 1984 (tougher disclosure); Act 41, SLH 1984 (cease-and-desist orders and consultant review); Act 42, SLH 1984 (time share administrator); and Act 114, SLH 1985 (bonding and seven-day cancellation period).
8. Section 514E-1, HRS.

Chapter 2

1. Section 16-106-38, Hawaii Administrative Rules.
2. Section 16-106-39, HAR.
3. Letter to Charles W. Key, Esq., Chair of the Hawaii State Bar Association's Real Property and Financial Services Section, from Jasmine Fujiwara Uehara, Time Share Administrator, November 12, 1991.

4. Sections 16-106-4 and 16-106-4.5, HAR.
5. Section 16-106-4, HAR.
6. *Reefshare, Ltd. v. Nagata*, 70 Hawaii Reports 93, 1988.
7. Chapter 721, Florida Statutes, 1991.
8. Memorandum to Hawaiian Timeshare Resorts from Audrey Hughey, Regional Account Executive, Resort Condominiums International, Inc., Subject: Annual Maintenance Fee, June 29, 1992.
9. Florida, Office of the Auditor General, *Performance Audit of the Real Estate Time-Share Regulation Program*, Report No. 11227, Tallahassee, Florida, May 23, 1989.
10. Section 16-106-12, HAR.
11. Section 514A-83.6, HRS.
12. Section 16-106-12, HAR.
13. Section 721.14, Florida Statutes, 1991 and Harry D. Miller and Marvin B. Starr, *Current Law of California Real Estate*, vol. 7, 2nd ed., San Francisco, Bancroft-Whitney Co., 1990, p. 144.
14. Memorandum to Noe Noe Tom, Licensing Administrator, Professional and Vocational Licensing Division, DCCA, from Sheryl Nagata, Time Share Administrator, Subject: Department-Wide Bond Study (Time Share), May 29, 1990.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs on October 6, 1992. A copy of the transmittal letter to the department is included as Attachment 1. The response from the department is included as Attachment 2.

The department agrees with our recommendation that Chapter 514E should be reenacted. It also agrees that the time share law should be amended to address emerging problems in plan management and will propose legislation to that effect. On clarifying the relationship between the time share law and the condominium law, the department acknowledges our concerns but requires a period of review beyond the 1993 session before it can propose amendments to the Legislature.

The department further agrees that the application of the rules on promotional material has been excessive in some instances. Therefore, it will propose an amendment to the rules, permitting a single disclosure statement per time share promotional document. In addition, the department agrees to carry out our recommendation on the monitoring of time share booths by implementing a revised booth registration form by the end of 1992.

The department does not agree with our recommendation that it repeal the section of the rules entitled Conduct. It says the provision is a necessary extension to time share salespersons of the established code of conduct for real estate salespersons. Furthermore, the department disagrees with our position that it lacks the authority to register sales agent employees or independent contractors who work for sales agents, and outside public contacts (OPCs) who work for acquisition or sales agents. Nevertheless, the department agrees to discontinue registering OPCs on December 31, 1993. Finally, concerning our recommendation that it include a report on time sharing in its annual report to the Legislature, the Department believes it is already meeting this requirement.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor
(808) 587-0800
FAX: (808) 587-0830

October 6, 1992

C O P Y

The Honorable Robert A. Alm, Director
Department of Commerce and Consumer Affairs
1010 Richards Street
Honolulu, Hawaii 96813

Dear Mr. Alm:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Sunset Evaluation Report: Time Sharing*. We ask that you telephone us by Thursday, October 8, 1992, on whether you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Thursday, November 5, 1992.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

A handwritten signature in cursive script, appearing to read 'marion m. higa'.

Marion M. Higa
State Auditor

Enclosures

JOHN WAIHEE
GOVERNOR



ROBERT A. ALM
DIRECTOR

SUSAN DOYLE
DEPUTY DIRECTOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
1010 RICHARDS STREET
P. O. BOX 541
HONOLULU, HAWAII 96809

November 5, 1992

RECEIVED

Nov 5 2 42 PM '92

OFF. OF THE AUDITOR
STATE OF HAWAII

The Honorable Marion M. Higa, State Auditor
Office of the Auditor
State of Hawaii
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Mrs. Higa:

The Department of Commerce and Consumer Affairs ("department") appreciates the opportunity to respond to the Sunset Evaluation Report on Time Sharing. The report's recommendations will be responded to in the chronological order that they appear on pages 16-17 of the report.

1. "The Legislature should reenact Chapter 514E, Hawaii Revised Statutes, to continue the regulation of time share plans."

The department appreciates the strong statements in support of the regulatory protection afforded time share consumers. The department agrees that regulation of the time share industry should be continued, and that Chapter 514E, HRS, should be reenacted. The department acknowledges the support of the Office of the Attorney General and the concerted efforts of the following divisions that cooperatively forge a well-integrated and responsive network for consumers and industry. They are, the Regulated Industries Complaints Office, the Office of Consumer Protection, the Communications Office, and the Professional and Vocational Licensing Division to which the Time Share Program is attached.

2. "The Department of Commerce and Consumer Affairs should clarify the rules regarding disclosure on time share promotional material."

The report states that the requirements for time share promotional material are burdensome and unclear. However, established regulation reflects past industry practices.

Where marketing aspects of the time share industry have matured, administration can be revised to continue purposeful regulation of the industry. The focus is to protect consumers from harm. Therefore the following considerations are offered to address sub-issues that arise in time share promotional materials.

- a. The disclosure statement on signs. The department is awaiting an Attorney General opinion on the constitutionality of requiring the caption on promotional literature under commercial free speech. Such literature may include paper materials as well as signs on tourist activity booths, stand-up "sandwich" signs in restaurants or lobbies, etc.
- b. One disclosure statement per document. The marketing pace and strategy of the industry has graduated from magazine ads and one-piece handbilling on streets to multi-paged real estate listings, multiple-piece marketing presentations such as mailers generated by mass market mail-houses, and multiple-vendor vacation enhancement plans packaged in brief-case size boxes.

The statute authorizes the exact language to be printed. The administrative rule implements the requirement on all printed material used in connection with the sale of time share plans. Thus the letter of the law permits no less a standard for the protection of consumers. The department agrees that in some instances the letter of the law in its practical application is excessive.

The department will propose an amendment to the rule to permit a single disclosure statement per promotional document, whether the document is a single-faced page, a double-sided page, or a multi-paged document such as a real-estate listing, or brochure. An amendment will also be proposed under the deceptive trade practices section, to include a disciplinary provision against delivering to the consumer a multi-piece document separated or detached from the disclosure statement.

- c. Stamps and stickers. The department agrees with the finding that stamps and stickers provide inadequate assurance that the disclosure statement will be

communicated. The department will propose an amendment to the rule to specify that the disclosure caption be printed on promotional materials.

3. "The Department of Commerce and Consumer Affairs should repeal Section 16-106-2.5 of the rules titled Conduct and the provisions requiring registration of the employees and independent contractors of acquisition and sales agents."

- a. Conduct.

Section 16-106-2.5, Hawaii Administrative Rules (HAR), entitled "Conduct" is claimed to contain standards that on record have never been asserted in an administrative cause of action, and that are so vague as to be unenforceable that it should be repealed. The department disagrees with this recommendation.

The provision is a necessary extension of the established code of conduct expected of all real estate salespersons. It was originally adopted in section 16-99-3, HAR, to implement Chapter 467, HRS, Real Estate Brokers and Salesmen. Time share brokers and sales agents are licensed under Chapter 467, HRS, and are subject to Chapter 16-99, HAR. The department believes it has the necessary authority to extend the code of conduct expected under real estate licensure to time share salespersons as well.

The history of actions based on this particular rule may not have been found in the auditor's review. However, as an established standard of conduct in the real estate industry, enforcement actions may be found pursuant to the real estate code.

- b. Registration Requirements.

The department disagrees with the finding that it has questionable authority to register (1) sales agent employees or independent contractors who work for sales agents and (2) outside public contacts who work for acquisition or sales agents. The statute does in fact provide authority to register these persons. The definition of a "sales agent" in 514E-1, HRS, means "a person who sells or offers to sell for compensation a

time share interest in a time share plan...." Where the sales agent employees, independent contractors and outside public contacts, participate with the principal broker in the offer or sale of an interest in real property, they are required to register and furnish evidence of licensure under section 514E-10(c), HRS.

There are two different types of outside public contacts ("OPCs"). First there are sales agents who also conduct activities as an OPC to draw people to sales presentations. Persons who concurrently perform acts as OPCs are required to be registered because they are sales agents.

Then there are individuals whose purpose is to attract and invite persons to sales presentations but who do not engage in real estate sales. It is true that individuals of this second type need only be listed by the sales agent or acquisition agent. Responsibility for the acts of an OPC on this level is already stated in section 16-106-50, HAR, which reads, "A real estate broker who employs an OPC who is not licensed pursuant to chapter 467, HRS, shall be responsible for the acts of the OPC."

The department has been considering the elimination of OPC registrations. In recognition of the Auditor's recommendation, the practice of registering individuals as OPC's on a separate form will be discontinued as of December 31, 1993. OPC's holding registrations current through 1993 will not be required to renew registration for 1994-1995 or thereafter.

4. "The Director of Commerce and Consumer Affairs should propose legislation to clarify the relationship between the time share law and the condominium law."

The department acknowledges that the time share law and administrative rules must be read in conjunction with the condominium law and rules. We have and will continue to work with the Real Estate Commission on appropriate interfacing of statutory authorities. The department will be researching and analyzing the issues raised in the

Auditor's Report and any other concerns we may have relating to the two laws. The 1993 Legislative Session will be targeted to raise issues. The complexity of the two laws and the need to involve the industry and public require an extended period of review beyond the 1993 session before reasonable amendments can be proposed to the Legislature.

5. "The time share law should be amended to authorize time share owners to discharge plan managers, to require management to adopt and distribute an annual operating budget, and to require an annual financial audit of the plan. The director should explore alternatives to the plan manager's bond such as requiring maintenance fees to be deposited with trust companies to reduce the bond."

The department agrees that the emerging issues on plan management must be addressed. Many complex relationships are involved. The management issues developing in the time share industry are similar to management issues in condominium law. We will continue to study and discuss each of the issues on operating budgets, financial audits, maintenance fees, discharge of plan managers, and the plan manager bond. After appropriate consideration, a legislative proposal will be presented.

6. "The time share office should implement its revised booth location form. The department should include a section on the time share program in its annual report to the Legislature."
 - a. Monitoring of time share booths.

The booth registration forms were generically developed for use in all counties. However, it is apparent that especially for Maui County, requirements to meet local ordinances on coastal zone management and historic districts, are not adequately reflected. Recommendations from each of the county planning departments will be incorporated in a revised form to be implemented by the end of 1992. Additional administrative rules will also be considered to clarify compliance requirements expected from the differing county jurisdictions. Annual renewal registrations may also be considered to track compliance with new state and county requirements.

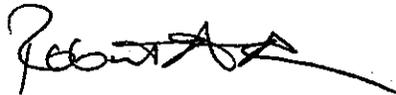
The Honorable Marion M. Higa
November 5, 1992
Page 6

b. Annual Reports.

The department does provide a report on time sharing as part of its annual report to the Legislature. Time sharing was initially reported under separate title in two departmental reports to the Legislature which covered the years 1968-1983, and 1983-1986. The time share administrator and office are placed as a program within the Professional and Vocational Licensing Division. Reports relating to time share were thus included under this division for the years 1987 through 1992. The department believes this fulfills the requirement under Chapter 514E, HRS. However, if the Legislature prefers a separate annual report, the department is willing to so provide.

Thank you for the opportunity to comment on the findings and recommendations of this sunset evaluation report.

Very truly yours,



Robert A. Alm
Director

A BILL FOR AN ACT

RELATING TO TIME SHARING PLANS.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Chapter 514E, Hawaii Revised Statutes, is
2 amended by adding a new section to be appropriately designated
3 and to read as follows:

4 "§514E- Plan management. (a) For each fiscal year, the
5 plan manager, or the board of the association if there is no plan
6 manager, shall adopt an operating budget and distribute copies to
7 all members of the association. At a minimum, the budget shall
8 contain the following:

- 9 (1) The estimated revenues and operating expenses of the
10 association;
11 (2) Information as to whether the budget has been prepared
12 on a cash or accrual basis;
13 (3) The total cash reserves of the association as of the
14 date of the budget;
15 (4) The estimated cash reserves the association will
16 require to maintain the property;
17 (5) A general explanation of how the estimated cash
18 reserves are computed; and
19 (6) The amount the association must collect for the year to

1 fund the estimated cash reserves.

2 (b) The plan manager, or the board of the association if
3 there is no plan manager, shall arrange for an annual independent
4 audit of all of its books, conducted by a certified public
5 accountant in accordance with generally accepted auditing
6 standards. A copy shall be provided to the director, and
7 additional copies shall be made available to any member of the
8 association, and any prospective purchaser, upon request.

9 (c) If an association employs a plan manager, the contract
10 of the plan manager shall be subject to renewal on an annual
11 basis by a majority vote of the owners voting. A plan manager
12 may also be discharged by vote of the board or by a majority vote
13 of the owners and the termination shall be effective sixty days
14 after written notice is transmitted to the plan manager, unless
15 the parties agree on a shorter period of time. A plan manager
16 may cancel the manager's contract at any time, and the
17 termination shall be effective sixty days after written notice is
18 transmitted to the board, unless the parties agree on a shorter
19 period of time. When a plan manager's contract is terminated,
20 the board shall either engage a new plan manager for the
21 association or shall assume all management responsibilities."

22 SECTION 2. Section 26H-4, Hawaii Revised Statutes, is

1 amended as follows:

2 1. By amending subsection (c) to read as follows:

3 "(c) The following chapters and sections are hereby
4 repealed effective December 31, 1993:

5 (1) Chapter 452 (Board of Massage)

6 (2) Chapter 453 (Board of Medical Examiners)

7 (3) Chapter 460 (Board of Osteopathic Examiners)

8 (4) Chapter 461J (Board of Physical Therapy)

9 (5) Chapter 463E (Podiatry)

10 (6) [Chapter 514E (Time Sharing Plans)

11 (7)] Sections 804-61 and 804-62"

12 2. By amending subsection (i) to read as follows:

13 "(i) The following chapters are hereby repealed effective
14 December 31, 1999:

15 (1) Chapter 436E (Board of Acupuncture)

16 (2) Chapter 442 (Board of Chiropractic Examiners)

17 (3) Chapter 444 (Contractors License Board)

18 (4) Chapter 448E (Board of Electricians and Plumbers)

19 (5) Chapter 464 (Professional Engineers, Architects,
20 Surveyors and Landscape Architects)

21 (6) Chapter 465 (Board of Psychology)

22 (7) Chapter 468E (Speech Pathology and Audiology)

