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M E M O R A N D U M

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TO: **FILE**

FROM: **ERB**

DATE: **May 6, 2022**

RE: ***Lund et al. – Lone Mountain Shores Owners Association, Inc.*** **("Association") – bylaw amendments (parameters and required procedures)**

BACKGROUND:

Lone Mountain Shores subdivision (the "**Property**") is subject to the Amended and Restated Declaration of Covenants, Conditions, and Restrictions and Easements for Lone Mountain Shores of record in the Register's Office for Claiborne County, Tennessee (together, with all amendments, the "**Declaration**" or the "**Covenants**") for the benefit of the real property lots situated within the Property and the Owners thereof. Section 1.02 of the Declaration provides that "[t]hese Covenants create specific rights and privileges which may be shared and enjoyed by all owners and occupants of any part of the Property in accordance with the provisions of Section 4.03 Delegations of Use." Section 4.03 (Delegation of Use) of the Declaration provides that:

> Any Owner may delegate, in accordance with the Bylaws, his/her right of enjoyment to the Common Area and facilities to the members of his/her family or the Owner's accompanied guests.

Pursuant to the Declaration, Section 2.03, the Lone Mountain Shores Owners Association, Inc., a Tennessee nonprofit corporation (the "**Association**"), is "charged with the rights and obligations set forth in these Covenants." The Bylaws of the Association recorded in BK/PG: 1555/290, Claiborne County Register's Office govern the operation and administration of the Association, (the "**Bylaws**"). The governing body of the Association is its Board of Directors (the "**Board**"), which has the powers and duties as set forth in the Bylaws for administration of the Property by the Association. (*See* Declaration, Section 3.02; Bylaws at Article I, Section 2, and

Article III). The provisions of the *Tennessee Nonprofit Corporation Act*, Tenn. Code Ann. Sections 48-51-101, *et. seq.* (the "**Nonprofit Act**") also apply to the Association and the Board.

Section 11.02 of the Declaration (Amendment) provides that "[t]these Covenants may be materially amended only by a unanimous vote of the board and the affirmative vote of fifty-five percent (55%) of the Owners voting by absentee ballot. Any approved amendment must be recorded in the Office of the Register of Deeds for Claiborne County, Tennessee." In contrast, Article VI (Amendments) of the Bylaws reads:

> These Bylaws may be amended from time to time by action of the Board, unless specifically prohibited by the Covenants or these Bylaws. Before approving any material change to the Bylaws, the Board must notify Owners of the proposed change and provide Owners with the opportunity to see the proposed new Bylaws. If, within 30 days after sending such notification, 10% or more of the Owners request in writing a meeting to discuss the proposed change, the President will call a meeting for open discussion of the subject; otherwise, the changes will become effective at the end of the 30-day notice period. If a meeting is held in accordance with this Section, the board will reconsider the proposed new Bylaws in light of the discussion at the meeting and take such further action, if any, as the Board deems appropriate.

Notably, however, Section 12.04 (Conflict between Documents) of the Declaration provides that the Declaration "shall control" in the case of any conflict between the Covenants therein and the Bylaws. Thus, the procedures established in Article VI (Amendments) of the Bylaws (assuming otherwise valid), may at most apply to proposed Bylaw amendments to the extent not in conflict with the Declaration.[1] However, any amendment purporting to expand, restrict or affect Owner use of their property within the Property is presumably "material" and thus probably superseded by the procedure established by the Declaration (Sections 11.02 and 11.03) for approving/effectuating such amendments (e.g. unanimous Board approval followed by affirmative vote by Ballot of at least 55% of members).

FACTS/ANALYSIS:

The Property was developed as the vacation-type resort style community and with few primary residents. The serial advertisement and renting of Dwellings to families or small groups of unrelated persons (e.g. a group on a weekend fishing trip) has for years been the allowed practice within the Property (collectively, "**Rental Practice**"). Many Owners have engaged in such Rental Practice for years without interruption or challenge, perhaps even purchased their Lots/Dwellings by inducement with the understanding that they would be able to do so, and the Association has for years acquiesced in this Rental Practice. There are serious concerns among Owners that prevention or obstruction of easy Rental Practice within the Property might make Owner Dwellings less desirable and substantially lower property values, in contravention of the purpose

[1] Tenn. Code Ann. § 48-52-106(b) states that "the bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or the charter." Additionally, Tenn. Code Ann. § 48-53-102(3) empowers the TVPOA to "***[m]ake and amend bylaws, not inconsistent with its charter*** or with the laws of this state, for regulating and managing the affairs of the corporation…"

and intent of the Declaration and the Association. Intending to address/resolve these Owner concerns regarding Rental Practice, the prior Board proposed several amendments to the Declaration and Bylaws.

In this regard, prior Board meeting minutes dated September 7, 2021 suggest that voting ballots for proposed Declaration and Bylaw amendments would be "sent to all owners for vote." These minutes do not state whether the Board unanimously approved the proposed amendments or exactly when the subject voting ballots (each, a "**Ballot**") were sent to the owners for vote. However, it is assumed that the member vote by Ballot on the proposed amendments occurred sometime in October 2021 (and the text of the mailer along with each Ballot suggests unanimous Board approval in stating that "Pursuant to the Covenants and By-Laws the following changes have been reviewed and approved by the Board to present to the Owners for a vote. … The Board is therefore asking the Owners to render their vote.").

Each Ballot submitted to vote three (3) proposed amendments to the Declaration, plus one (1) proposed Bylaw amendment together with proposed Policy and Procedures, attached thereto. Ballot item 2 proposed to amend the Declaration to strike the word "accompanied" from Section 4.03 (Delegation of Use) of the Declaration. Records confirming the results of the vote by Ballot have not been disclosed by the Association, although we understand that the 55% affirmative vote of members was not received as required to approve that proposed amendment to the Declaration. On the other hand, Ballot item 3 presumably passed since the Secretary of the Association certified December 8, 2021 and submitted for recording at BK/PG: 1593/353, Claiborne County Register's Office new Covenant language relating to Section 6.32 (Camping) which was supposedly "approved by owner vote of LMSOA covenant Section 6.32 Camping" (the "**Camping Amendment**"). *See* Declaration, Sections 11.02 and 11.03.

Ballot item 4 proposed changes to the Article IX of the Bylaws to add the following to the Miscellaneous Provisions:

> Owners of Rental Property shall be required to Register their property for rental, and; require owners who rent their properties to provide renters with a copy of the LMSOA Rental Requirements. Specific language and requirements relating to each topic shall be contained in the board Policies and procedures.

(herein sometimes referred to as the "**Rental Registration Amendment**")

Although records confirming the results have not been formally disclosed by the Association, we understand that the results returned by Owners voting by Ballot were in fact 167 in favor relative to 76 against the Ballot item 4 Rental Registration Amendment. Assuming Ballot item 4 may be construed as a "material" amendment to Property restrictions and thus superseded by the approval procedure established by the Declaration, those returns raise the question whether the 55% affirmative vote of members was received as required to approve that proposed amendment to the Bylaws. The current Board denies that those voting returns met the required percentage threshold because the affirmative votes comprised less than the "Majority of the Owners." However, Article II, Section 9(a) of the Bylaws (Voting Requirements) states that "Voting by written ballot is approved if a majority of Owners ***responding*** vote in favor of the

action." Here, of the 243 Ballots cast, 176 apparently voted to approve Ballot item 4, which equates to 72% in favor of approval – well exceeding the 55% approval threshold of Owners "responding." Further, the Ballots as mailed appear substantially compliant with the requirements of Article II, Section 10(b) of the Bylaws.

While the substantive results of Ballot item 4 vote remain undisclosed or unrecognized by the current Board, the Ballot vote was presumably also procedurally valid inasmuch as the Secretary of the Association certified and submitted the Camping Amendment for recording. In other words, the Board cannot seriously dispute the procedural validity of the amendments submitted to vote by Ballot considering the recorded Secretary's Certificate confirming approval of the Camping Amendment (item 3 on the Ballot), nor can the Board reasonably dispute that the Owners responding voted in favor of adopting the item 4 on the Ballot. Thus, the Secretary should certify/record the approved Rental Registration Amendment to the Bylaws in the form of Ballot item 4 just as the Camping Amendment to the Declaration was certified/recorded and implement the same.

Notwithstanding the foregoing, even if all Ballot proposals were validly approved by the required percentage of Owners, it is unclear whether such amendments effectively resolve the ambiguities in the Declaration relating to Rental Practice. For instance, the Ballot item 4 Bylaw amendment would be moot and of no effect if the controlling provisions the Declaration, specifically Sections 2.06, 4.03, 6.04 and 6.07 were deemed when together to preclude continued Rental Practice. These provisions of the Declaration specifically state as follows:

> Section 2.06 - "Dwelling" shall mean … provided such use ls for single family residential purposes only.
>
> Section 4.03 (Delegation of Use). Any Owner may delegate, in accordance with the Bylaws, his/her right of enjoyment to the Common Area and facilities to the members of his/her family or the Owner's accompanied guests.
>
> Section 6.01 (Rational for Land Use Restrictions). It is the desire of the Association to preserve and enhance the property values of the Property, to prevent nuisances, and to maintain an attractive area for residential purposes.
>
> Section 6.04 (Residential Use Only). All Lots shall be used for single family residential purposes only, and no commercial use is permitted. This restriction is not to be construed to prevent rental of any Lot or any dwelling for private single-family residential purpose or to prevent a n Owner from conducting home occupations in a Dwelling, provided such occupations (a) are subordinate to the primary residential use, (b) occupy no more than twenty percent (20%) of the Dwelling's floor area, and (c) employ not more than two (2) persons. Examples of prohibited commercial uses of a Lot or any dwelling include providing the services of or operating as a restaurant, an inn, a boarding house, or a bed-and-breakfast or providing other atypical rental services of a commercial nature. Examples of non-single family residential purposes use of a Lot or any dwelling include, but are not limited to; occupancy by two or more unaffiliated individuals or groups that

function as independent housekeeping units, owners or their agents occupying any part of the property at the same time as renters; utilizing the Lot or any dwelling as a fraternity, sorority or dorm complex; or using the Lot or any dwelling as a Group home or institution of any kind. All provisions of these Covenants and of any rules, regulations, or use restrictions promulgated pursuant hereto that govern the conduct of Owners and that provide for sanctions against Owners also apply to all occupants of any lot.

Section 6.07 (Rental). Lots and Dwellings may be rented only for private single-family residential purposes subject to the following provisions:

a. The Renting to unaffiliated individuals or groups at the same time is prohibited.

b. Tenants are required to abide by all LMS Governing Documents.

c. Owners are responsible for the actions of their tenants. Each Owner shall take appropriate steps and should put in place additional rules, limitations ad restrictions as necessary to ensure that tenants do not conduct deleterious activities or otherwise create a nuisance to other Owners.

d. All rules, regulations, or use restrictions of these Covenants promulgated pursuant hereto that govern the conduct of Owners and that provide for sanctions against Owners also apply to all occupants of any Lot.

Some Associations have tried to prohibit short-term rentals, relying on commercial-use restrictions. The argument is that if you are using your property as a short-term rental, you are effectively using it for a commercial purpose. The question of whether residential only (e.g. non-commercial) use provisions authorize the Association to prohibit short-term rentals is largely inconsistent from state to state.[2]

Notably, however, in the recent Tennessee Court of Appeals case *Pandharipande v. FSD Corp*., 2022 Tenn. App. LEXIS 172 (Tenn.Ct.App. February 3, 2022) concerning whether a Declaration provision that "*each Lot shall be used for residential and no other purposes*" effectively prohibited Plaintiff from short-term renting his property, the trial court was held to have correctly found that the restrictive covenants precluded leasing the property as a non-residential

[2] For instance, when considering this issue, an appeals court in Michigan held that an Association that prohibited short-term rentals based on a commercial-use restriction did not exceed its authority. *Eager v. Peasley*, 911 N.W.2d 470, (Mich. Ct. App. 2017). Noting that "provid[ing] temporary housing" to vacationers is a "profit-making enterprise," the court concluded that "the act of renting property to another for short-term use is a commercial use, even if the activity is residential in nature." On the other hand, based on the principle that unclear restrictions should be construed in favor of the free use of property, a North Carolina court held that a generalized restriction against non-residential use by itself was insufficient authority for an Association to prohibit short-term rentals. *Wise v. Harrington Grove Cmty. Ass'n*, 584 S.E.2d 731 (2003). The Texas Supreme Court likewise came down in favor of the property owner in *Tarr v. Timberwood Park Owners Ass'n,* 61 Tex. Sup. Ct. J. 1174 (2018). In that case, the Association relied on a restriction that only allowed properties in the community to be used as single-family residences. According to the *Tarr* Court, the provision did not plainly forbid short-term rentals because, as long as renters used the home for residential purposes, the covenant was satisfied.

short-term vacation rental. The court reasoned that because the Plaintiff's only use of the property was for a business purpose, short-term vacation rentals to third parties, his non-residential use of the property was in violation of the restrictive covenants. The court recognized the importance of intent, and determined that there was a relevant distinction between the principal use of a property for non-residential purposes and "the incidental use of a dwelling for purposes . . . from which the owner derives some income or profit but which may not . . . be termed a business or trade.". But since the Plaintiff's only use of the Property was for a business purpose for short-term vacation rentals to third parties, the Plaintiff's use was not incidental and thus violated the Declaration as a non-residential use.

Although the longstanding Rental Practice in Lone Mountain Shores may be factually nuanced or otherwise distinguished[3] from the facts specific to the *Pandharipande* case, it is clear that the most certain way for Owners to avoid any unwanted obstruction of short-term Rental Practice is to amend their Association's governing documents to unambiguously permit short-term rentals.

* * *

Irrespective of the foregoing Declaration provisions – which seem somewhat ambiguous in scope and intent – it is believed that most Owners prefer continued acquiescence to the Rental Practice. Regrettably, however, the current Board has refused to adopt/record the Rental Registration Amendment (approved by 72% of responding Owner votes) supposedly to avoid "legitimizing" the longtime Rental Practice. Apparently, this Board is also informing third-party property managers/realtors that Rental Practice will no longer be allowed on the Property, contrary to the believed preferences of most Owners.

Presumably such conduct is driven by the personal interests of several current directors, who unlike most Owners, are year-round residents and oppose the Rental Practice. However, the duty of loyalty imposed on the Board to the Association requires directors to act in good faith to promote the best interests of all Owners, and their corresponding fiduciary responsibility prevents directors from making decisions to further their personal interests and requires directors to perform the duties that the Board is obligated to carry out. As such, this current Board's resistance to carrying out Ballot item 4 and rumored efforts to sabotage the Rental Practice in favor of their personal interests as primary/year-round residents arguably contravenes their respective duties to the Owners/Association as a whole in this long-developed vacation-type resort style community.

CONCLUSION/RECOMMENDATION:

For the foregoing reasons, concerned Owners may consider taking steps aimed at removing any self-serving directors and replacing them with individuals more willing to carry into effect the will of the Owners, as related to the Rental Practice in question and otherwise. Thereafter, it is recommended that action be taken as necessary to validly adopt and effectuate Amended and

[3] More detailed analysis of these ambiguous Declaration provisions relative to the specific facts involved in the Lone Mountain Shores Rental Practice or consideration of the application or effect of equitable principles such as waiver, estoppel, laches, acquiescence, etc., is beyond the scope of this memorandum.

Restated Declaration of Covenants and Restrictions and Bylaws to clarify ambiguities in the existing governing documents and confirm Owner rights and limitations regarding Rental Practice.

Note Regarding Director Removal/Replacement: Section 3.02 of the Declaration (and Article III, Section 1 of the Bylaws) states that "Board members shall hold office until their `successor has been elected or appointed, unless removed from office pursuant to Article III, Section 8 of the Bylaws," which provides that the "Owners may remove any one or more directors, with or without cause, at a special meeting specifically called for that purpose." Under Article II, Section 4 of the Bylaws, the "Association shall hold a special meeting of its Owners upon … the written demand(s) to the Secretary by Owners holding at least ten percent (10%) of all votes entitled to be cast on any issued to be considered at the proposed special meeting. Notice of any such special meeting shall be propounded to the Owners not less than 30 nor more than 60 days before the meeting date. Article II, Section 5 of the Bylaws.

Under Article II, Section 8 of the Bylaws, "… a quorum shall consist of the Owners present at a meeting either in person or by representation." Article II, Section 7 and Article X(i) of the Bylaws say with regard to voting that a "Majority of the Owners" means the owners of "more than fifty percent of the voting rights of all Owners. (any Owner in default of assessment obligation loses voting rights until cure) of the Bylaws. However, Article II, Section 9(b) states that "[v]oting at a meeting by Owners is approved ***if a majority of the Owners <u>in attendance</u> vote in favor of the action***." (e.g. majority of Owners present affirmatively vote to remove directors).

Article III, Section 7 (Vacancy) of the Bylaws provides that the Board may appoint a replacement director, but "[i]f the Directors remaining in office constitute less than a quorum of the Board, the replacement director(s) must be elected by a vote of Owners." Directors may only be elected by written ballot per Bylaws, Article II, Sections 10 and 11—under Section 11(c), notwithstanding any other provision of the Bylaws, "the candidate receiving the most votes (a plurality) for any open position on the Board shall be elected to that position."