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IN THE SUPERIOR COURT OF ARIZONA

COUNTY OF MARICOPA

NICDON 10663, LLC, an Arizona limited liability company,

Plaintiff,

vs.

DESERT MOUNTAIN MASTER ASSOCIATION, an Arizona nonprofit corporation,

Defendant.

No. CV 2018-015165

MEMORANDUM IN SUPPORT OF APPLICATION FOR TEMPORARY RESTRAINING ORDER AND/OR A PRELIMINARY INJUNCTION

INTRODUCTION

Defendant Desert Mountain Master Association (the "Association") and all properties within the Desert Mountain community are subject to a recorded declaration of covenants, conditions, and restrictions. On or about July 17, 2018, the Association recorded a document with the Maricopa County Recorder purporting to amend the community's governing documents to impose leasing restrictions and prohibit certain short-term leases of less than thirty (30) days. The Association has stated that it will start enforcing the restriction effective January 1, 2019. As the rental restriction is invalid, improper, and was not adopted in accordance with the Association's governing documents or Arizona law, Plaintiff requests that the Court enter a preliminary injunction enjoining the Association from enforcing the ban pending the outcome of a final hearing on the merits in this case. Plaintiff has already signed numerous leases and runs the risk

of breaching them and/or being charged excessive and unreasonable fees if the Association's unlawful amendment is enforced during the lawsuit.

FACTUAL BACKGROUND

The planned community of Desert Mountain consists of approximately 2,397 residential lots or units. [Verified Complaint, ¶ 5] The Association and all properties within the Desert Mountain community are subject to recorded covenants, conditions, and restrictions. [*Id.*, ¶ 6] The current iteration of the Desert Mountain deed restrictions is the Second Amended and Restated Master Declaration of Covenants, Conditions, Restrictions, Assessments, Charges, Servitudes, Liens, Reservations and Easements for Desert Mountain recorded on June 21, 2011 at Recorder No. 2011-0517763 (the "Declaration").[1] [*Id.*, ¶ 6]

Plaintiff Nicdon 10663, LLC ("Nicdon") owns property within the Association located at 10663 East Fernwood Lane, Scottsdale, Arizona 85262 (the "Property"). [*Id.*, ¶ 1] Plaintiff purchased the Property in 2015 for investment purposes including renting it for various terms. [*Id.*, ¶ 8] At the time Nicdon acquired the Property, the Declaration did not prohibit short-term rentals or impose any restrictions giving Nicdon any foreseeable notice that the Association could restrict short-term rentals. [*Id.*, ¶ 8] In fact, Section 1.2.2 of Exhibit E to the Declaration, entitled "Leasing Restrictions," even affirmed the right to lease so long as the "entire Dwelling Unit on a Lot" was leased. [*Id.*, ¶ 9]

In 2018, the Association sought to amend the Declaration to prohibit owners, such as Nicdon, from leasing to "Ineligible Renter(s)" for terms of less than thirty (30) days."[2] [*Id.*, ¶ 11] The Association defines "Ineligible Renter" essentially as anyone that does not already own a home within the Association or is not a Desert Mountain Club Member. [Id., ¶ 11] The following is a timeline of events that led up to the Association recording the Amendment on July 17, 2018:

[1] See a true and correct copy of the Declaration attached as Exhibit 1 to the Verified Complaint.

[2] See a true and correct copy of the Amendment attached as Exhibit 2 to the Verified Complaint.

- In March 2018, the Association's Board of Directors proposed a Major Decision to amend Section 1.2.2 of Exhibit E in order to limit short-term rentals;
- In April 2018, the Association notified the membership of a vote on the proposed short-term rental amendment and mailed ballots for the proposed amendment to the membership;
- In May 2018, the Association stated that it had received a total of 1,768 ballots for 2,397 members and that, of those ballots returned, 1,323 members voted in favor of the short-term rental amendment; and
- In July 2018, the Association recorded the Amendment.

[*Id.*, ¶¶ 14-16, 19, 21]

The Amendment prohibits owners from leasing their properties to "Ineligible Renters for a term of less than thirty (30) days" and further provides, in part, that:

> [N]o Owner may advertise his or her Lot, including any and all buildings located thereon, as available to an Ineligible Renter(s) for a lease term of less than thirty (30) days in duration. A Lot, including any and all buildings located thereon, may, however, be leased to an Eligible Renter(s) for a term that is less than thirty (30) days in duration.

[*Id.*, ¶ 24]

The Association has stated that it will commence enforcing the ban on January 1, 2019. It has published a schedule of fines charging an owner fines in $5,000 increments for any owner who advertises property for rent to ineligible renters for a term of less than 30 days."[3] [*Id.*, ¶ 25] If an owner fails to terminate advertising within 48 hours, it will be subject to a $5,000 fine. A second advertisement will be $10,000, a third will be $15,000, and so on. [*Id.*, ¶ 25] A similar incremental fine policy applies to owners who actually lease their property to "an ineligible renter." [*Id.*, ¶ 25] The first offense merits a fine of $5,000 or "the amount of the rent plus 20%" and subsequent violations "will increase in $5,000 increments, as described above." [*Id.*, ¶ 25]

Nicdon depends on the revenue generated from the Property and has already entered into several leases for 2019. [*Id.*, ¶ 26] Considering that the ban starts during the most marketable

[3] See a true and correct copy of the fine policy attached as Exhibit 7 to the Verified Complaint.

months in Arizona, Nicdon stands to lose significant revenue and will suffer significant hardship if it is forced to stop renting the Property. Furthermore, Nicdon will be in breach of existing leases and will suffer hardship if it is forced to honor their existing agreements and accept the unreasonably punitive fines imposed by the Association.

ARGUMENT

I. THE STANDARD FOR A PRELIMINARY INJUNCTION.

An injunction may serve to undo accomplished wrongs, or to prevent future wrongs that are likely to occur.[4] There are two tests courts use in determining whether to grant a preliminary injunction. Under the "traditional" test, the moving party must demonstrate that: (1) he has a likelihood of prevailing on the merits; (2) he will suffer irreparable injury if interim relief is denied; (3) the balance of potential harm tips in his favor; and (4) the public interest favors granting the injunction.[5]

Under the so-called "alternative" test, a court will issue a preliminary injunction if (1) the moving party raises "serious questions" on the merits; and (2) the balance of hardships tips decidedly in his favor.[6] Applying the traditional test, the Arizona Court of Appeals has held that injunctive relief is appropriate once a moving party demonstrates a protectable interest, because irreparable injury can be presumed.[7] Plaintiffs are entitled to a preliminary injunction under either test.

II. PLAINTIFFS ARE LIKELY TO PREVAIL ON THE MERITS BECAUSE THE AMENDMENT IS INVALID, IMPROPER, AND WAS NOT ADOPTED IN ACCORDANCE WITH THE DECLARATION OR ARIZONA LAW.

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[4] *TP Racing, L.L.L.P. v. Simms*, 232 Ariz. 489, 495, ¶ 21, 307 P.3d 56, 62 (App. 2013); *see also* A.R.S. § 12-1801.

[5] *See, e.g., Northern Alaska Envtl. Ctr. v. Hodel*, 803 F.2d 466, 471 (9th Cir. 1986); *Powell-Cerkoney v. TCR-Montana Ranch Joint Venture*, 176 Ariz. 275, 280, 860 P.2d 1328, 1333 (Ct. App. 1993).

[6] *Caribbean Marine Serv. Co. v. Baldridge*, 844 F.2d 668, 674 (9th Cir. 1988).

[7] *Phoenix Orthopedic Surgeons, Ltd. v. Peairs*, 164 Ariz. 54, 59, 790 P.2d 752, 757 (Ct. App. 1989).

A. The Amendment Required, but Did Not Receive, Unanimous Consent.

In *Dreamland Villa v. Raimey*, the Court of Appeals held that amendments to declarations must be with unanimous consent if they "unreasonably alter the nature of the covenants."[8] The Court of Appeals in *Dreamland Villa* held that "any amendment must be directed at, and is limited by, the scope of restrictions and *cannot create new obligations not previously mentioned.*"[9] Associations cannot "use the Declaration's amendment provision as a vehicle for imposing a new and different set of covenants, thereby substituting a new obligation for the original bargain of the covenanting parties."[10]

The *Dreamland Villa* court held that an amendment that "would unreasonably alter the nature of the covenants," such as those having a "substantial and unforeseeable" impact on owners, must be disallowed because "such servitudes [cannot] be imposed non-consensually under the generic amendment power."[11] New restrictions that "unreasonably alter the nature of the covenants" cannot be foisted on unsuspecting owners, who purchased their lots or units in the absence of such restrictions.[12]

The Amendment in this case drastically alters the nature of the restrictions imposed on owners. Nicdon's members purchased their lot when the Association's governing documents contained no rental limitations or any other provision remotely suggesting that the Association could amend the Declaration to prohibit short term rentals. In fact, Section 1.2.2 of Exhibit E to the Declaration, entitled "Leasing Restrictions," even affirmed the right to lease so long as the "entire Dwelling Unit on a Lot" was leased. This express language essentially tells prospective

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[8] *Dreamland Villa Community Club, Inc. v. Raimey*, 224 Ariz. 42, 226 P.3d 411 (App. 2010).

[9] *Id.* at 49, 226 P.3d at 418 (emphasis added).

[10] Id. citing with approval Colorado and North Carolina cases, including *Armstrong v. Ledges Homeowners Ass'n, Inc.*

[11] *Id.*

[12] *Dreamland Villa*, 224 Ariz. at 49, 226 P.3d 418.

owners that there are no restrictions on rentals as long as you do not operate a "boarding house." Nicdon relied on the Declaration and this restriction when it purchased the Property.

Now, the Association wants to change the covenants by banning owners from leasing their units to "ineligible renters" (i.e., outsiders) for periods of less than thirty (30) days. This represents a substantial, material, and unforeseeable change in the deed restrictions. Owners such as Nicdon who bought properties specifically for investment purposes and to rent them in an unrestricted manner are being deprived of one of the most basic tenets of private property ownership: the ability to lease their property to generate income. The Amendment prevents Nicdon from using the Property for the primary reason it was purchased and completely deprives it of the benefit of the bargain.

The Court of Appeals expressly warned about allowing an association to impose new burdens without the unanimous consent of all owners: "[W]e must disallow the new burdens, as the circumstances of this development indicate a lack of proper notice that such servitudes could be imposed non-consensually under the generic amendment power."[13] Such a warning is particularly appropriate here given that just fifty-five percent (55%) of the entire membership voted to approve the new restrictions and more than 400 people in the community expressed their opposition to the new restrictions (with another 629 not voting one way or the other). [Verified Complaint, ¶ 19]

B. The Amendment on Its Face is Arbitrary and Unreasonable.

As discussed above, Arizona law is clear that an association may not "unreasonably alter the nature of the covenants."[14] Courts have recognized that associations must act reasonably and cannot enforce restrictions or take acts that are arbitrary, unreasonable, or selective.[15] The

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[13] *Id.*

[14] *Id.*, at 51, 226 P.3d at 420.

[15] *Id.*; *Ahwatukee Custom Estates Mgmt Ass'n, Inc. v. Turner*, 196 Ariz. 631, 635, 2 P.3d 1276, 1280 (App. 2000) (citing cases); *Armstrong*, 633 S.E.2d 78, 88 (a court "may determine that an amendment is unreasonable, and therefore invalid and unenforceable...."); *Tierra Ranchos*

Restatement, likewise, recognizes that an association's rulemaking powers are limited to the adoption of "reasonable" rules and that associations do not have the power to adopt rules that "restrict the use or occupancy of, or behavior within, individually owned lots or units."[16] "Rules are not valid unless they are also reasonable."[17]

Here, the Association still allows owners to rent short-term to who the Association defines as "eligible renters" but prohibits owners from signing these same leases with "ineligible renters." Conveniently, the Association defines "eligible renters" as "Members of the Association and/or individuals and/or entities that are Members of the Desert Mountain Club." [Exhibit 2, p. 2] In light of the general prohibition against advertising, it appears that the primary reason for this distinction is to confer benefits to the Club but deny owners these same benefits. There is no logical reason for letting certain people rent short term but not letting others rent short term. Therefore, on its face, the Amendment is arbitrary and unreasonable.

C. The Amendment Did Not Even Receive the Lesser Percentages that the Declaration Required to Pass Certain Amendments as Set Forth in Sections 1.33, 5.20, or 19.1 of the Declaration.

The Association, through the Amendment, sought to amend Section 1.2.2 of Exhibit E. Section 19.1 of the Declaration generally provides that amendments "may be adopted only with the affirmative written consent of a Majority of all of the Members...." [Exhibit 1, p. 48] The attempt to amend or add use restrictions, however, is designated as a "Major Decision" that has a separate procedure set forth in Section 5.20:

> All Major Decisions shall first be approved by the Board of Directors through a written Board resolution. Thereafter, the Master Association shall give notice to all Owners of the proposed Major Decision and of their right to object to it. If no more

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Homeowners Ass'n v. Kitchukov, 216 Ariz. 195, 202, 165 P.3d 173, 180 (App. 2007).

[16] Restatement (Third) of Property (Servitudes) § 6.7(a)(1) and (3); Restatement (Third) of Property (Servitudes) § 6.10, cmt. f ("the association and the community members acting collectively have a duty to treat community members fairly and to exercise discretionary powers reasonably"). In the absence of contrary authority, Arizona courts look to the Restatement for guidance. *Kitchukov*, 216 Ariz. at 201, 165 P.3d at 179.

[17] *Id.*, Comment b.

> than ten percent (10%) of the Members object to the Major Decision in writing within forty-five (45) days after notice is given, the Board is authorized to implement the Major Decision without a meeting or vote of the members. If, however, more than ten percent (10%) of the Members object to the Major Decision in writing within forty-five (45) days after notice is given, the Major Decision may only be authorized if approved by eligible Members holding two-thirds (2/3) of the eligible votes in the Master Association who are present in person or by absentee ballot at a meeting of the Master Association called for this purpose.

[Exhibit 1, p. 21][18]

Also applicable to the analysis of the validity of the Amendment is Section 1.33 of the Declaration, which provides, in part, that "any specified fraction or percentage of the Members means that fraction or percentage of the total votes entitled to be cast by Members, with respect to a given matter." [*Id.*, p. 6]

Section 5.20 does not mention quorum. It specifically states that two-thirds must vote in favor of the proposed amendment, either at a meeting or by absentee ballot (in other words, the Association cannot assume that someone who does not vote is in favor of the amendment as it might under the ten percent provision). Because it references a specified fraction of the Members, Section 1.33 provides that it is a fraction "of the total votes entitled to be cast by Members" (*i.e.*, 2,397). Otherwise, a use restriction could be amended if only three people showed up at a meeting and two of them voted in favor of the amendment. Any other interpretation ignores the limiting language of Section 1.33 ("any specified fraction or percentage of the Members means that fraction or percentage of the total votes entitled to be cast by Members").

Assuming the Association's calculations are correct, just 1,323 of the 2,397 members voted in favor of the Amendment. This is a little more than fifty-five percent (55%), well shy of the 67% needed to pass the Amendment.

[18] It bears mentioning that this provision appears to be unlawful because it improperly shifts the burden to the homeowner to expressly vote "no" on a proposed "Major Decision" or else their abstention will essentially be deemed a "yes" vote.

D. The Voting Process Was Otherwise Invalid and Defective.

The Planned Community Act provides that ballots are subject to certain criteria. Under A.R.S. § 33-1812, they must (1) set forth the proposed action; (2) they must provide an opportunity to vote for or against each proposed action; (3) the ballot is valid for only one specified election and expires automatically after the completion of the election or meeting; (4) the ballot specifies the time and date by which it must be received in order to be counted; (5) the ballot does not authorize another person to cast votes on behalf of the member; (6) the completed ballot shall contain the name, address and signature of the person voting; and (7) all materials must be retained for at least one year. Of course, members of a community can only act at meetings, so there also must be an annual, regular, or special meeting.

Here, there was never any annual, regular, or special meeting. The information accompanying the ballot specified that the ballots "must be received no later than Tuesday, May 1, 2018, 3 pm, Mountain Standard Time," but it did not specify that a meeting would actually be called on this date and at this time. In addition, the ballot falsely stated that the "**Quorum Requirement** for the Special Meeting" was "25% of the Members" and that two-thirds of those who attended needed to vote in favor of the Amendment. In other words, the ballot inaccurately stated that the short-term rental prohibition could be enacted provided just 600 people sent in ballots and 395 of them voted in favor of the new use restriction. This is inconsistent with the Declaration.

III. PLAINTIFF PRESENTLY FACES IRREPARABLE INJURY.

Defendant's illegal enforcement of its invalid Amendment prohibits Nicdon's ability to rent the Property for periods of less than thirty (30) days, depriving it of the primary purpose for which they purchased the Property. Should interim relief be denied, this matter is unlikely to be resolved until after January 1, 2019, depriving Nicdon of the free use and enjoyment of their

property. Irreparable harm is presumed if a party can establish a protected interest.[19] In this instance, the interest to be recognized and protected is Nicdon's right to the use and enjoyment of the property. Nicdon's ownership of their unit, in other words, establishes a protectable interest and the irreparable harm they face is from Defendant's enforcement of an invalid Amendment.

IV. THE BALANCE OF HARDSHIPS TIPS SHARPLY IN PLAINTIFF'S FAVOR.

In determining whether a preliminary injunction should be granted, relative hardship is the critical factor, for which a movant must show either (1) probable success on the merits and the possibility of irreparable injury; or (2) the presence of serious questions and 'the balance of hardships tips sharply in his favor.[20]

As set forth above, Nicdon has shown probable success on the merits because a contract cannot be modified without the consent of all parties to that contract. Moreover, Nicdon has established the possibility of irreparable injury should they lose the ability to rent its property for a period of less than thirty (30) days, which will unnecessarily require the Association, and most likely the individual members thereof, to compensate Nicdon for the damages it sustains while their Property sits vacant. Nicdon, therefore, satisfies the first test.

Nicdon also satisfies the second test. The validity of the Amendment presents serious questions and, if not enjoined, Nicdon will be deprived of the central reason it acquired the Property. Defendant, conversely, will not suffer any hardship or prejudice as any injunction will simply maintain the existing status quo.

This will allow Nicdon to continue to use its property in the same manner it always has. Conversely, Nicdon will be deprived of its freedom to use and enjoy its Property if Defendant is not enjoined from enforcing the invalid Amendment. Defendant is not legally entitled to "change…the uses to which any unit is restricted" without unanimous consent of the unit owners. If the preliminary injunction is not issued, Nicdon will suffer far greater harm in the loss of its

[19] *See, e.g., Peairs*, 164 Ariz. at 59, 790 P.2d at 757.

[20] *TP Racing, L.L.L.P. v. Simms*, 232 Ariz. at 495, ¶ 21, 307 P.3d at 62.

freedom to use and enjoy its property by leasing it to short-term renters, as it has done for the last several years.

V. THE PUBLIC INTEREST FAVORS PLAINTIFF.

As mentioned above, when similar matters are presented to Arizona courts, ambiguities in restrictive covenants are generally resolved in favor of a homeowner's free use and enjoyment of his property.[21] This is consistent with the Restatement (Third) of Property: Servitudes § 6.10 (2000). Arizona courts follow the Restatement.[22] According to § 6.10, unless a declaration says otherwise, unanimous approval is generally required to prohibit or materially restrict the use or occupancy of, or behavior within, individually owned lots or units.

VI. DEFENDANT IS LIKELY TO ATTEMPT TO ENFORCE THE INVALID AMENDMENT TO ITS DECLARATION IF RELIEF IS NOT GRANTED.

Defendant has stated that it will commence enforcing the ban of short-term rentals beginning on January 1, 2019, which includes the punitive $5,000, $10,000, $15,000 etc. fines pursuant to the invalid Amendment to the Declaration. Nicdon seeks to preserve the status quo pending a final ruling in this case prior to any such enforcement action taking place.

CONCLUSION

For the above reasons, Plaintiff requests that the proposed form of Order attached to the Application for Temporary Restraining Order/Preliminary Injunction be entered, and that Defendant be enjoined from denying short-term rentals pending the resolution of this matter.

DATED this 12 day of December 2018.

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[21] *Wilson*, 211 Ariz. at 514, 123 P.3d at 1151.

[22] *See Tierra Ranchos Homeowners Ass'n*, 216 Ariz. at 201, 165 P.3d at 179.