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15 Attorneys for Plaintiffs

16 **IN THE SUPERIOR COURT OF THE STATE OF ARIZONA**  
17 **IN AND FOR THE COUNTY OF NAVAJO**

18 GORDON GROSS and LILIANA  
19 GROSS, husband and wife; 854 PINE  
20 CREEK, LLC, an Arizona limited liability  
21 company; BALD EAGLE RETREAT,  
22 LLC, an Arizona limited liability company;  
23 1501 RAINBOW VIEW, LLC, an Arizona  
24 limited liability company; LAKESIDE  
25 FAMILY INVESTMENTS, LLC, an  
26 Arizona limited liability company,  
27 STEVEN A. KERNAGIS AND SANDRA  
28 K. KERNAGIS, trustees of THE STEVEN  
AND SANDRA KERNAGIS TRUST  
DATED MARCH 17, 2014; THOMAS P.  
ZEHRING AND JEANNETTE ROSE  
ZEHRING, trustees of THE ZEHRING  
LIVING TRUST DATED MARCH 1,  
2001; and JEANNETTE ZEHRING,

Plaintiffs,

v.

THE SHORES AT RAINBOW LAKE  
COMMUNITY ASSOCIATION, an  
Arizona nonprofit corporation,

Defendant.

No.:

VERIFIED COMPLAINT

(Quiet Title; Breach of Implied Covenant  
of Good Faith and Fair Dealing)

For their Complaint against the Defendant, the Plaintiffs allege as follows:

**PARTIES, JURISDICTION, AND VENUE**

1. Plaintiffs, Gordon Gross and Liliana Gross, are husband and wife and owners

1 of real property located in Navajo County at 2366 Bald Eagle Point, Lakeside, which is  
2 within the Shores and subject to the recorded instruments described below.

3           2.       Plaintiff 854 Pine Creek, LLC is an Arizona limited liability company and is  
4 the owner of real property located in Navajo County at 854 Pine Creek Drive, Lakeside,  
5 which is within the Shores and subject to the recorded instruments described below.

6           3.       Plaintiff Bald Eagle Retreat, LLC is an Arizona limited liability company  
7 and is the owner of real property located in Navajo County at 2343 Bald Eagle Point,  
8 Lakeside, which is within the Shores and subject to the recorded instruments described  
9 below.

10          4.       Plaintiff 1501 Rainbow View, LLC is an Arizona limited liability company  
11 and is the owner of real property located in Navajo County at 1501 Rainbow View Drive,  
12 Lakeside, which is within the Shores and subject to the recorded instruments described  
13 below.

14          5.       Plaintiff Lakeside Family Investments, LLC is an Arizona limited liability  
15 company and is the owner of real property located in Navajo County at 2321 Bald Eagle  
16 Point, Lakeside, which is within the Shores and subject to the recorded instruments  
17 described below.

18          6.       Plaintiffs, Thomas P. Zehring and Jeannette Rose Zehring, Trustees under  
19 the ZEHRING LIVING TRUST are husband and wife and, with Jeannette Zehring, are  
20 owners of an undivided 50% interest of the real property located in Navajo County at 685  
21 Pine Creek Drive, Lakeside, which is within the Shores and subject to the recorded  
22 instruments described below.

23          7.       Plaintiffs, Steven A. Kernagis and Sandra K. Kernagis, Trustee of the  
24 STEVEN AND SANDRA KERNAGIS TRUST dated March 17, 2014, are husband and  
25 wife and owners of an undivided 50% interest of the real property located in Navajo County  
26 at 685 Pine Creek Drive, Lakeside, which is within the Shores and subject to the recorded  
27 instruments described below.

28



1 Shores made up of 24 townhomes.

2 17. The Cove is governed by the Master Declaration as well as that certain  
3 Amended and Restated Declaration of Covenants, Conditions and Restrictions for  
4 Rainbow Cove at the Shores (“the Townhome Declaration”), which is recorded in the  
5 Navajo County Recorder’s Office at Number 1989-07118 as amended by Number 2006-  
6 36535 and incorporated by reference.

7 18. The Townhome Declaration provides that The Cove is subject to the terms  
8 of the Master Declaration. Thus, any amendment to the Master Declaration would apply to  
9 The Cove and effectuate an indirect amendment to the Townhome Declaration.

10 19. The Master Declaration, prior to the Amendment at issue, did not prohibit or  
11 restrict the ability of a homeowner to rent or lease their lots, regardless of duration, except  
12 for a requirement to provide notice to the Master HOA of the terms of the lease.

13 20. Of the 164 single-family homes in The Shores, only 30 are occupied full-  
14 time by the owners thereof.

15 21. Of the 24 townhomes in The Cove, only 2 are occupied full-time by the  
16 owners thereof.

17 **Relevant Provisions of the Master Declaration**

18 22. With respect to leasing, Section 2.30 of the Master Declaration provides:

19 **Leasing of Lots.** No Owner may lease less than his entire Lot. Upon leasing  
20 his Lot, an Owner shall promptly notify the Association of the  
21 commencement date and termination date of the lease and the names of each  
22 lessee or other person who will be occupying the Lot during the term of the  
23 Lease.

24 *See* Master Declaration, Navajo County Recorder’s Office Number 2001-17716, at p. 16.

25 23. Section 2.18 of the Master Declaration provides that leasing of a residence  
26 by the owner shall not be considered a trade or business. *Id.* at p. 12.

27 24. Section 4.5 of the Master Declaration provides that every owner of a lot or  
28 parcel shall automatically be a Member of the Association. *Id.* at p. 22.

29 25. Section 4.6 of the Master Declaration provides that each Member of the

1 Association is entitled to one vote. *Id.* at p. 22 – 23.

2 26. Section 5.3 of the Master Declaration provides as follows:

3 **5.3. Extraordinary Assessment.** The Association may levy an assessment  
4 against an Owner and such Owner’s Lot or Parcel, for the following  
5 expenses:

- 6 (i) Any expense caused by the misconduct of such Owner;
- 7 (ii) Any expense incurred by the Association pursuant to Section 6.2 of  
8 the Declaration as a result of the Owner’s failure to maintain his Lot  
9 or Parcel, and the improvements located thereon, in accordance with  
10 the terms of this Declaration.
- 11 (iii) Any expenses incurred by the Association pursuant to Section 6.1 of  
12 this Declaration as a result of repairs, maintenance or replacements to  
13 the Common Areas or to portions of the Lots and Parcels the  
14 Association is obligated to maintain which is caused by the willful or  
15 negligent act of an Owner, his family, guest, invites or animals.
- 16 (iv) Any expense incurred by the Association in towing any vehicle or  
17 equipment of an Owner pursuant to Section 2.26 of the Declaration.

18 *Id.* at p. 27.

19 27. Section 9.2 of the Master Declaration provides that it may be amended by  
20 the affirmative vote of not less than sixty-seven percent (67%) of the votes in each class of  
21 membership. *Id.* at p. 40.

### 22 History of Vacation Rentals

23 28. Vacation rentals are commonplace in Navajo County because of the cool  
24 summers and beautiful winters.

25 29. The Shores, since its inception, has been established as a vacation community  
26 where people stay for short-term periods and has marketed itself as a “resort” community.

27 30. On information and belief, significant numbers of the homeowners in both  
28 The Shores and The Cove participated in the short-term leasing common to The Shores  
and The Cove prior to purchasing their homes in the Community.

31. The Homeowners have all used their respective property as short-term  
rentals.

32. The ability to lease the property as a short-term rental was a highly desirable

1 feature considered by each of the Homeowners when they purchased their respective  
2 properties.

3 33. The vacation rental market was revolutionized by the establishment of  
4 platforms such as VRBO and Airbnb. These platforms allow homeowners to market their  
5 homes to more potential renters by broadening the potential renter base and allowing for  
6 individuals to rent their property on a short-term basis – often under 30 days.

7 34. Each of the Homeowners purchased their property in the Community  
8 because the Community was known and held out as one which, not only allowed, but  
9 encouraged short-term rentals.

10 35. Each of the Homeowners relies on the income from the short-term rentals for  
11 mortgage servicing, repairs, maintenance, utilities, and other carrying costs for their  
12 properties.

13 36. The Homeowners have been using their respective properties as short-term  
14 rentals without incident for years.

15 37. Each Homeowner personally uses their property regularly and allows short-  
16 term renters on a somewhat sporadic basis.

17 **The Improper Tactics Used to “Pass” the Amendment**

18 38. On August 15, 2020, the Master HOA issued a straw ballot to the Community  
19 to explore the Community’s interest in amending the Master Declaration to add a short-  
20 term rental prohibition.

21 39. The ballot stated that short-term rentals cause increased noise, cars, and trash  
22 in the Community, but also provided that short-term rentals were a good source of income  
23 for individuals who could not otherwise afford a vacation home.

24 40. The purpose of the straw poll was to assess the opinion of the Community as  
25 to whether it wanted a short-term rental restriction in the Declaration and stated that if at  
26 least sixty seven percent (67%) of the Community was in favor, a vote would be held to  
27 amend the Master Declaration.

28 41. The tactics used by both the Master HOA (and the Townhome HOA acting

1 at its behest) were nothing short of underhanded and deceitful.

2 42. Pro-rental restriction members knocked on the doors of homeowners in the  
3 Community, called them repeatedly, and accosted them in public after the straw ballot  
4 indicated the proposed rental restriction lacked the necessary community support.

5 43. This underhanded and deceitful strategy implemented by the Master HOA  
6 (and the Townhome HOA acting at its behest) resulted in the required number of consent  
7 forms being submitted to propose an amendment to the Master Declaration.

8 44. On December 21, 2020, the Master HOA issued a memorandum regarding  
9 the proposed amendment to the Master Declaration. This memorandum was sent to all  
10 members of the Community and included an attached copy of the proposed rental  
11 restriction amendment to the Master Declaration.

12 45. The memorandum included consent forms which, when completed by a  
13 homeowner and returned, counted as a “yes” vote for the proposed rental restriction  
14 amendment.

15 46. The Master HOA requested that the Community return the consent forms no  
16 later than February 28, 2021.

17 47. The Homeowners requested that a committee be formed for drafting a fair  
18 short-term rental policy – one which did not restrict rental duration to less than 30 days.

19 48. The Master HOA agreed to appoint an independent committee to work with  
20 the Homeowners on drafting the short-term rental provision.

21 49. Despite this promise, the committee only met twice and never delivered the  
22 promised collaboration and action.

23 50. Approval of the rental restriction was secured, in large part, by false  
24 representations by the Presidents of the Master HOA and the Townhome HOA.

25 51. In January of 2021, Tom Pyzdek – a member of the Community – wrote a  
26 column that was published in the White Mountain Independent. This column included  
27 various misstatements and half-truths which were relied upon by residents of the  
28 Community when filling out the aforementioned Consent Forms.

1           52.    The statements made in the White Mountain Independent were false and  
2 corrected by a property owner who used his residence as a short-term rental.

3           53.    Despite knowing that the statements were false, the Master HOA did not  
4 notify the Community in any way that the statements were false or to correct what had been  
5 published. Rather, the Master HOA President exacerbated the situation by putting forward  
6 further misinformation and falsehoods.

7           54.    Meanwhile, the President of the Townhome HOA, who upon information  
8 and belief was acting at the behest of the Master HOA, lied to a resident of The Cove to  
9 secure his signed consent form.

10          55.    Specifically, the Townhome HOA President told an owner that the  
11 Homeowners were offered a 7-day rental duration option that had been rejected and, based  
12 on that misrepresentation, the owner returned his signed consent form voting to approve  
13 the proposed rental restriction amendment.

14          56.    This vote was significant because this owner’s vote was the deciding vote  
15 that provided the sixty-seven percent (67%) majority of Class A Members.

16          57.    On February 26, 2021, *before the closing of voting*, the Master HOA  
17 purported to adopt the proposed amendment to Section 2.30 of the Declaration prohibiting  
18 short-term rentals (“the Amendment”) and recorded the same as more specifically  
19 described below.

20          58.    On March 15, 2021, the Homeowners sent a letter to the Master HOA  
21 requesting copies of the consent forms underlying the purported vote for review.

22          59.    This letter set forth numerous concerns regarding how the consent forms  
23 were obtained, including:

24           a.    Neighbors were told that the Homeowners were made an offer to  
25 compromise and they refused when, in fact, no offer was ever made and no  
26 discussion was actually had with the Homeowners.

27           b.    The neighbors were never informed that the Homeowners lowered the  
28 number of renters and hired a manager to oversee the rentals and handle

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complaints.

- c. The Master HOA repeatedly blamed issues within the Community on the Homeowners (and by implication their short-term renters) without any support.
- d. The Master HOA never produced the “hundreds of complaints” it allegedly received against renters of the Homeowners’ properties.
- e. Neighbors were falsely told that members of the Homeowners were investors.
- f. The neighbors were falsely told that there were hundreds of extra people in the Community during the summer because of the Homeowners rentals.
- g. Neighbors reported that the tactics used by the Shores HOA to obtain consent forms put bill collectors to shame.

See 3/15/2021 Letter attached as **Exhibit A**.

**Recording and Enforcement of the Amendment**

60. Notwithstanding the above, the Master HOA recorded the Amendment with the Recorder of Navajo County, Arizona at Instrument No. 2021-04383 on March 3, 2021, which is incorporated by reference.

61. The Amendment provides as follows:

1. Article 2, Section 2.30 shall be deleted in its entirety and replaced with the following:

2.30. Leasing of Lots.

(A) After December 31<sup>st</sup>, 2021, no Lot may be leased for a term less than thirty (30) days.

(B) No portion of a Lot may be leased, other than the entire Lot, and then only to a Single Family. For purposed of this Section 2.30, a Single Family may not consist of more than four (4) individuals who are unrelated by blood, marriage or legal adoption.

(C) An Owner who leases his Lot shall provide the following information to the Association at least ten (10) days before the commencement of the lease term:

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- (i) the commencement date and expiration date of the lease term;
- (ii) the names and contact information of any adults occupying the Lot during the lease term; and
- (iii) the address and telephone number at which the Owner (or Owner’s agent) can be contacted by the Association during the lease term.

(D) Any agreement for the lease of a Lot shall provide that the term of such lease shall be subject in all respects to the provisions of the Project Documents and that any failure by the Lessee to comply with the terms of the Project Documents shall be a default under the lease. Any Owner who leases a Lot must provide the Lessee with a copies of this Declaration, the Architectural Committee Rules and the Association Rules and is responsible for assuring the Lessee’s compliance therewith. The Owner shall be liable for any violation of this Declaration, the Architectural Committee Rules or the Association Rules by the Lessees or other persons residing in the Lot and their guests or invitees and, in the event of any such violation, the Owner, upon demand of the Association, shall immediately take all necessary actions to correct any such violations.

62. On December 19, 2021, the Master HOA sent out a newsletter addressing the enactment of the Amendment and the consequences for violating the same. The newsletter stated:

On Friday, December 17, the Shores board met in executive session with our attorney Wendy Ehrlich for the purpose of obtaining legal advice regarding enforcement of the short term rental restriction CC&R amendment. She will be preparing a letter to go out to the community in January. What we can tell you now is that the board plans to *strictly enforce the amendment and the monetary penalties will be substantial.*

See Newsletter attached as **Exhibit B** (emphasis added).

63. On January 14, 2022, the Master HOA sent out another letter addressing the enforcement of the new rental restriction, stating:

The Association intends to impose monetary penalties against owners who do not rent their properties in accordance with the short-term rental restriction. Reasonable monetary penalties may include amounts equal to the advertised rate for the rental. The Association reserves the right to bypass a courtesy notice if an owner has a history of violating the short-term rental restriction. Under Arizona law, the CC&R’s are a contract between the Association and its members, and by statue, owners are required to rent their homes in conformance with the time limitation in the amendment. [Citing to A.R.S. § 33-1806.01]

See Newsletter attached as **Exhibit C** (emphasis added).



1 Declaration.

2 73. The Amendment is invalid and unenforceable due to the conduct, described  
3 above, that was undertaken by the Master HOA in seeking to adopt the Amendment.

4 74. The Amendment is invalid and unenforceable because it was passed without  
5 compliance with the procedures required under the Master Declaration and Arizona law.

6 75. At least 20 days prior to the filing of this Complaint, each Plaintiff tendered  
7 to the Master HOA a Notice disclaiming any interest in above identified properties under  
8 the Amendment and declaring the Amendment invalid, together with the sum of \$5.00 from  
9 each Plaintiff pursuant to A.R.S. § 12-1103(B), and requested that the Master HOA execute  
10 the Notice.

11 76. The Master HOA has ignored Plaintiffs' requests and indicated during an  
12 open meeting that it will continue to enforce the Amendment until instructed otherwise by  
13 a court.

14 77. As a direct and proximate result, the Master HOA is liable to Plaintiffs for  
15 their attorneys' fees and costs incurred herein pursuant to A.R.S. § 12-1103(B).

16 78. Pursuant to Rule 55(b)(1), *Ariz.R.Civ.P.*, in the event that judgment by  
17 default is rendered in favor of Plaintiffs, Plaintiffs seek reasonable attorneys' fees in an  
18 amount not less than \$5,000.00.

19 **WHEREFORE**, Plaintiffs, Gordon Gross and Liliana Gross, 854 Pine Creek, LLC,  
20 Bald Eagle Retreat, LLC, 1501 Rainbow View, LLC, Lakeside Family Investments, LLC,  
21 Steven A. Kernagis and Sandra K. Kernagis, trustees of The Steven and Sandra Kernagis  
22 Trust Dated March 17, 2014, Thomas P. Zehring and Jeannette Rose Zehring, trustees of  
23 The Zehring Living Trust Dated March 1, 2001, and Jeannette Zehring, demand judgment  
24 against Defendant, The Shores at Rainbow Lake Community Association, for:

- 25 (a) Quiet title as to the Amendment;
- 26 (b) A declaration that the Amendment is invalid and unenforceable as a matter  
27 of law;
- 28

- 1 (c) A declaration that the Master HOA is precluded from imposing penalties and  
2 enforcing the failure to pay penalties through liens or otherwise under  
3 authority purportedly created by the Amendment;
- 4 (d) An injunction enjoining the Master HOA from asserting any claim  
5 whatsoever to the properties, or any part thereof, under the Amendment;
- 6 (e) An injunction enjoining the Master HOA from attempting to enforce the  
7 Amendment;
- 8 (f) Attorneys' fees and costs pursuant to A.R.S. §12-1103(B); and
- 9 (g) Such further relief as the Court may deem equitable and just.

**COUNT II**

**(Breach of Implied Covenant of Good Faith and Fair Dealing)**

11 79. Plaintiffs hereby repeat and reiterate the allegations set forth above as though  
12 fully set forth herein.

13 80. Arizona law implies a covenant of good faith and fair dealing in every  
14 contract. *See, Rawlings v. Apodaca*, 151 Ariz. 149, 153, 726 P.2d 565, 569 (1986).

15 81. Arizona law recognizes that a party breaches the implied covenant of good  
16 faith and fair dealing by (a) exercising express discretion in a way inconsistent with a  
17 party's reasonable expectations and (b) by acting in ways not expressly excluded by the  
18 contract's terms but which nevertheless bear adversely on the party's reasonable expected  
19 benefits.

20 82. Defendant breached the implied covenant by, among other things: (a)  
21 changing the benefits bargained for under the Master Declaration with respect to short-  
22 term rentals by adopting an amendment which was not authorized or properly noticed by  
23 the Master Declaration; (b) administering a vote for adopting said amendment which failed  
24 to comply with the requirements of the Master Declaration; and (c) even if the requirements  
25 of the Master Declaration were complied with, adopting an amendment that bears adversely  
26 upon the Homeowners' reasonably expected benefits as to short-term rentals.

27 83. As a result of Defendant's breach of the covenant of good faith and fair  
28 dealing, Plaintiffs have suffered and will continue to suffer damages to be proven at trial.

1           84. As a direct and proximate result, the Master HOA is liable to Plaintiffs for  
2 their attorneys' fees and costs incurred herein pursuant to A.R.S. §§ 12-341 and -341.01.

3           85. Pursuant to Rule 55(b)(1), *Ariz.R.Civ.P.*, in the event that judgment by  
4 default is rendered in favor of Plaintiffs, Plaintiffs seek reasonable attorneys' fees in an  
5 amount not less than \$5,000.00.

6           **WHEREFORE**, Plaintiffs, Gordon Gross and Liliana Gross, 854 Pine Creek, LLC,  
7 Bald Eagle Retreat, LLC, 1501 Rainbow View, LLC, Lakeside Family Investments, LLC,  
8 Steven A. Kernagis and Sandra K. Kernagis, trustees of The Steven and Sandra Kernagis  
9 Trust Dated March 17, 2014, Thomas P. Zehring and Jeannette Rose Zehring, trustees of  
10 The Zehring Living Trust Dated March 1, 2001, and Jeannette Zehring, demand judgment  
11 against Defendant, The Shores at Rainbow Lake Community Association, for:

- 12           (a) Breach of the covenant of good faith and fair dealing;  
13           (b) Compensatory, incidental, and consequential damages in an amount to be  
14 proven at trial, plus interest as allowed by law;  
15           (c) Post-judgment interest at the statutory rate;  
16           (d) Attorneys' fees and costs pursuant to A.R.S. §§ 12-341 and -341.01;  
17           (e) Attorneys' fees and costs related to any collection effort of monetary  
18 damages due; and  
19           (f) Such further relief as the Court may deem equitable and just.

20           DATED this 10th day of February, 2022.

21           DYER BREGMAN & FERRIS, PLLC.   WONG & CARTER, PC.

22           BY /s/ Stockton D. Banfield  
23 Stockton D. Banfield  
24 Charles M. Dyer  
25 Attorneys for Plaintiffs

26           BY /s/ Matthew A. Klopp  
27 Rick K. Carter  
28 Matthew A. Klopp  
Attorneys for Plaintiffs