ARIZONA COURT OF APPEALS
DIVISION ONE

GORDON GROSS and LILIANA GROSS, husband and wife; *et al*., Plaintiffs/Appellees/Cross-Appellants, v. THE SHORES AT RAINBOW LAKE COMMUNITY ASSOCIATION, an Arizona nonprofit corporation, Defendant/Appellant/Cross-Appellee.	Case No.: 1 CA-CV-23-0394 Navajo County Superior Court Case No.: S0900CV202200042

COMBINED ANSWERING BRIEF ON APPEAL

and

OPENING BRIEF ON CROSS-APPEAL

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ANSWERING BRIEF ON APPEAL

I. INTRODUCTION

[¶1] When it comes to amending deed restrictions, Arizona law is clear:

> an HOA cannot create new affirmative obligations where the original declaration did not provide notice to the homeowners that they might be subject to such obligations. … [because] we do not enforce unknown terms which are beyond the range of reasonable expectation.

Kalway v. Calabria Ranch HOA, LLC, 252 Ariz. 532, 538, ¶14, 506 P.3d 18, 24 (2022) (citations omitted). Because contract law seeks the original intent and reasonable expectations of the parties, "substantial, unforeseen, and unlimited amendments" that are "entirely new and different in character, untethered to an original covenant" are disallowed. *Id.* ¶¶14-17; *see also Dreamland Villa Community Club, Inc. v. Raimey*, 224 Ariz. 42, 51, ¶38, 226 P.3d 411, 420 (App. 2010). In the context of deed restrictions and reciprocal covenants, the reason for this is equally clear:

> The law will not subject a minority of landowners to unlimited and unexpected restrictions on the use of their land merely because the covenant agreement permitted a majority to make changes to existing covenants.

Id. at ¶15 (quoting *Boyles v. Hausmann*, 517 N.W.2d 610, 617 (Neb. 1994)).

[¶2] The Shores at Rainbow Lake Community Association ("the Association") amended existing deed restrictions to impose a short-term rental restriction using a generic-amendment power. The trial court correctly found that

the short-term rental restriction was invalid under the above authority because it created a temporal restriction on leasing where no such restriction ever existed before. In fact, as this Court may recall from a prior appeal, there is a decades-long history of short-term rentals in the community dating back to such rentals by ***the original developer***. *See Horton v. Hartsook*, No. 1 CA-CV 08-0095, 2009 WL 2244503. Based on that history, this Court has already concluded that the deed restrictions allowed (and given the long history, intended) to allow people to lease their homes as short-term rentals. The trial court's decision should have come as no surprise to the Association as the law in Arizona, for over a decade, clearly prohibited the majority (or even a super majority) from imposing entirely new restrictions that were not reasonably foreseeable upon a minority. *See Dreamland, supra*.

[¶3] The Association implicitly acknowledges that Arizona law, under the Supreme Court's recent *Kalway* decision and this Court's older *Dreamland* decision, prohibits what the Association did here. The Association also knows the history of short-term rentals in the community discussed in *Horton*. It is presumably for that reason that the Association's Opening Brief largely discusses irrelevant statutes concerning what municipalities can do with respect to short-term rentals, irrelevant statutes concerning taxes, and inapposite cases from other jurisdictions. The Association does this because Arizona law requires the short-

term rental restriction be invalidated just as the trial court did. Rather than engage in a case-by-case refutation of every irrelevant and inapposite authority, the Homeowners focus this Court on how *Kalway* applies to the amendment at issue.

[¶4] Underlying *Kalway* and *Dreamland* and their discussion of "reasonable expectations" and foreseeability is an understanding that the law is often called upon, in a contract setting, to protect the powerless from the powerful. The Association does not like this, which is why the Association devotes much of its argument to pointing out that the Homeowners are less than a majority and that a super majority voted for the short-term rental restriction. Unfortunately for the Association, the number comprising the Homeowners does not matter in deciding this case any more than what a random court in Florida may have said about that state's condominium statutes. Arizona law is clear, and at least with respect to the short-term rental restriction, the trial court got it right.

[¶5] The Association may not like Arizona law, but it must abide by it just as the trial court did and this Court must. This Court should therefore affirm the trial court's ruling as to the invalidity of the short-term rental restriction.

II. FACTUAL AND PROCEDURAL HISTORY

The history of short-term rentals as permitted under the Declaration.

[¶6] The Shores at Rainbow Lake ("The Shores") is a residential community, comprised of 164 detached houses and 24 townhouses, located in

Pinetop-Lakeside, Arizona. (IRA 4 at p.4). As is common in a planned development, The Shores are governed by certain recorded Amended and Restated Covenants, Conditions, and Restrictions ("the Declaration"). (*Id.* at Ex.2).[1] Among other things, the Declaration sets forth the permissible and impermissible uses within The Shores and establishes a homeowner association, the Association, which has the authority to enforce the Declaration, create rules consistent with the Declaration, and otherwise do the types of things that homeowner associations are commonly known to do. (APPX-1 at Art. 4).

[¶7] The Homeowners own real property within The Shores, which they primarily use for personal vacation and rental purposes. (IRA 4 at p.4). Vacation rentals are common in Pinetop-Lakeside because of the cool summers and beautiful winters. (*Id*. at p.5). From the inception of The Shores, vacationers have been a mainstay of the community, often visiting for short-term periods to experience the beauty and serenity of Pinetop. (*Id*.). In fact, as noted by this Court in a prior appeal, the original developer and other owners have leased townhome units within The Shores, for periods as short as a few days, since the 1990s. (*Id.; see also Horton v. Hartsook*, No. 1 CA-CV 08-0095, 2009 WL 2244503 at ¶4).[2]

[1] A copy of the Declaration is annexed as Item No. 1 of the Appendix ("APPX").

[2] As noted in *Horton v. Hartsook*, the lease language in the Declaration governing the entirety of The Shores is "virtually identical" to the sub-declaration governing the townhouses. *Horton* at n.2. In addition to concluding that short-term leases

There is no dispute, as this Court has already concluded, that the Declaration not only "permits leasing" but also "does not exclude short-term leases" as such is consistent with the developer's intent and long-standing practice of offering short-term rentals within The Shores. *Id.* at ¶¶16, 22.

[¶8] Section 2.30 of the Declaration, as originally recorded,[3] does not contain any restriction as to whom can rent or for how long; the only restrictions are that owners must (a) lease their entire lot and (b) notify the Association of the lease and its terms:

> **2.30 Leasing of Lots**. No Owner may lease less than his entire Lot. Upon leasing his Lot, an Owner shall promptly notify the Association of the commencement date and termination date of the lease and the names of each lessee or other person who will be occupying the Lot during the term of the Lease.

(APPX-1 at Sec. 2.30). Further, Section 2.18 of the Declaration, which requires that lots be "used, improved and devoted exclusively to Single Family[4] residential use," expressly states that leasing is not a business and is consistent with the

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were permitted, this Court also rejected arguments concerning "transient occupiers" and "residences" that are strikingly similar to arguments raised by the Association for the first time in this appeal. *Id.* ¶¶17-22.

[3] Prior to the Declaration, The Shores was governed by a prior declaration that was recorded with the Navajo County Recorder in 1986 at Docket No. 825, Page No. 248. It contains a nearly identical Section 2.30 to the Declaration at issue in this appeal. (IRA 4 at p.5).

[4] As discussed more fully in the Opening Brief on Cross-Appeal, the definition of the term "Single Family" contained in Section 1.47 was altered by the Amendment.

"Single Family residential use" that otherwise precludes commercial activity:

> The leasing of a residence by the Owner thereof shall not be considered a trade or business within the meaning of this section.

(APPX-1 at Sec. 2.18). The Declaration also contains a generic amendment provision that allows for amendments upon affirmative vote of at least 67% of the owners. (APPX-1 at Sec. 9.2).

The Association records the Amendment to stop short-term rentals, and the Homeowners sue.

[¶9] In late 2020, the Association led an initiative to restrict short-term rentals of less than 30 days. (IRA 4 at pp.6-7). This culminated in the Association recording the First Amendment to Amended and Restated Declaration of Covenants, Conditions and Restrictions ("the Amendment"), which indicates that it is recorded upon the affirmative vote of 67% of the owners under Section 9.2 of the Declaration. (*Id.* at Ex.1).[5] The Amendment deleted the existing Section 2.30 and replaced it (in pertinent part) as follows:

> **2.30. <u>Leasing of Lots</u>.**
>
> (A) After December 31st, 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 purposes of this Section 2.30, a Single Family may not consist of more than four (4) individuals who are unrelated by blood, marriage or

[5] A copy of the Amendment is annexed as Item No. 2 of the Appendix.

legal adoption.

(APPX-2).[6]

[¶10] Shortly after the Association recorded the Amendment, the Homeowners filed this lawsuit asserting two causes of action (quiet title and breach of the implied covenant of good faith) that ultimately sought to invalidate the short-term rental restriction, enjoin its enforcement, and recover any money damages for rentals lost due to the Amendment. (IRA 1; 27). The Homeowners also sought a preliminary injunction to stop enforcement of the Amendment pending adjudication of the lawsuit; however, that motion was withdrawn as the Association eventually stipulated to delay enforcement of the Amendment (which stipulation ultimately mooted the Homeowners' damages for lost rentals). (IRA 19).

[¶11] The Homeowners moved for partial summary on the grounds that the Amendment, in particular the temporal leasing restriction, was invalid under both *Kalway v. Calabria Ranch HOA, LLC* and A.R.S. §33-1817(A).[7] (IRA 15). After

[6] The Amendment also included subsections (C) and (D) concerning information that is to be provided in the event of a lease. Although those subsections were also challenged below, they are not the subject of this appeal or cross-appeal.

[7] In the Complaint, the Homeowners also alleged that the Association failed to obtain the requisite votes and engaged in misconduct during the voting process. Because the trial court disposed of the case on purely legal grounds, the parties never conducted discovery or developed the factual record concerning these

briefing on the Homeowners' motion and the Association's cross-motion, the trial court invalidated the temporal restriction in subsection (A) of the Amendment but upheld subsections (B)-(D). (IRA 32). The Homeowners later filed a Notice (upon request of the trial court) indicating that they were abandoning their claim for money damages given that the Association's stipulation to delay enforcement had rendered such claims moot. (IRA 45). The trial court entered a Final Judgment, which the Association appealed. (IRA 46, 48).

[¶12] The Association asked this Court to dismiss its own appeal on the grounds that the Final Judgment was not truly final (despite the inclusion of Rule 54(c) language) because the Final Judgment did not expressly reference Count II (the Homeowners' claim for money damages). This Court granted the motion and remanded the case for entry of a new final judgment. (IRA 73). The trial court later entered the Amended Final Judgment. (IRA 71). The Association timely appealed, and the Homeowners timely cross-appealed. (IRA 74, 79). This Court has jurisdiction pursuant to A.R.S. §12-2101(A)(1).

III. STANDARD OF REVIEW

[¶13] This Court reviews an order granting a motion for summary judgment *de novo*. *Pi'Ikea, LLC v. Williamson*, 234 Ariz. 284, 285, ¶ 5, 321 P.3d 449, 450 (App. 2014). This Court will affirm the trial court's decision if there is no

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theories. If this Court reverses the trial court as to the short-term rental restriction, these alternative theories remain to be litigated.

legitimate factual issue and the moving party is entitled to judgment as a matter of law. *See Winsor v. Glasswerks PHX, L.L.C.*, 204 Ariz. 303, 306, ¶6, 63 P.3d 1040, 1043 (App. 2003). This Court will affirm the trial court when it reaches the correct result for any reason. *Citibank (Ariz.) v. Van Velzer*, 194 Ariz. 358, 359, ¶ 5, 982 P.2d 833, 834 (App. 1998). One appealing a summary judgment may not advance new theories or raise new issues to secure a reversal on appeal. *Best v. Edwards*, 217 Ariz. 497, 504, ¶28, 176 P.3d 695, 702 (App. 2008).

IV. LEGAL ARGUMENT

A. The Planned Communities Act does not displace the common law.

[¶14] Although the trial court's ruling concerning the Amendment was premised upon the foreseeability analysis under *Kalway v. Calabria Ranch HOA, LLC*, the Association's Opening Brief goes to great lengths to confuse this Court with a long dissertation concerning various municipal ordinances, state tax statutes concerning TPT licenses, and references to the Arizona Planned Communities Act. This dalliance in irrelevance culminates in the Association's ultimate conclusion – regardless of the *Kalway* analysis, the Association was *required* to record the Amendment because at least 67% of the votes were in favor of the Amendment.[8]

[8] The Homeowners have never conceded that the Amendment obtained the requisite number of affirmative votes and have always alleged that the vote was flawed and the Association never obtained the requisite number of votes. (IRA 27 at ¶¶72-75, 81). The trial court only assumed that the 67% vote was properly obtained for purposes of summary judgment. (IRA 32 at p.2).

(Op. Br. at p.26). While this "mandate" to record would perhaps serve as a defense to a claim for knowingly recording an invalid or fraudulent instrument, it is no defense to the Homeowners' claim to invalidate the Amendment under *Kalway*. After all, the entire purpose of the analysis in *Kalway* and the earlier *Dreamland* decision upon which it borrows is focused upon protecting the minority, the party with unequal bargaining power in this particular contract, from unforeseeable amendments later forced upon them by the majority that yields the greater power.

[¶15] It is not entirely clear why the Association wants to frame the issue of one of mandate. Perhaps the Association is attempting to avoid the consequences of the *Kalway* analysis, which invalidates the temporal leasing restriction in the Amendment. Perhaps the Association truly believes that it is *required* to record *anything* that receives the requisite number of votes regardless of its substance.[9] As the trial court correctly noted, Arizona law is clear that "A.R.S. §33-1817(A)(1) does not displace the common law, which prohibits some amendments **even if** passed by a majority vote." *Kalway*, 252 Ariz. at 537, ¶10, 506 P.3d at 23 (emphasis added). Therefore, under *Kalway*, even if the Association was compelled to record the Amendment, that does not answer the question of whether

[9] Given the duties that the Board owes to the members of the Association, an argument could be made that the Board is obligated to serve a gatekeeper function by refusing to record amendments that do not appear valid rather than rubber-stamping everything passed by the majority. In that case, the majority could take on the burden of bringing an action to force recordation.

the Amendment was valid under the common law.

[¶16] In any event, as expressly stated in *Kalway*, the statute does not displace the common law of contracts as it is applied to the particular type of contract here (deed restrictions). *Id.* Rather, the two must work together as is commonplace in common law jurisdictions such as Arizona. The Association must therefore comply, not only with A.R.S. §33-1817 in enacting amendments, but also the common law as espoused in *Kalway* that controls the validity of the substance of those amendments. Presumably, the Court is aware of how statutes and the common law interact as it recently applied *Kalway* when striking down an attempt to restrict short-term rentals in a planned community using a general-amendment-power provision. *See Village of Oakcreek Ass'n v. Bonham*, 2023 WL 6444337 (App. 2023) (holding that restriction on commercial business did not give notice of future amendment to restrict residential rentals).

B. <u>The short-term rental restriction is invalid under *Kalway* because it is new, unforeseen, and untethered to an original restriction.</u>

[¶17] Arizona law is settled that "a general-amendment-power provision may be used to amend only those restrictions for which the HOA's original declaration provided sufficient notice." *Kalway*, 252 Ariz. at 536, ¶1, 506 P.3d at 22. There is no dispute here that the Association relied upon the general-amendment-power under Section 9.2 of the Declaration in passing the Amendment. Therefore, the validity of the short-term rental restriction in the

Amendment hinges on whether the Declaration provided sufficient notice of a future durational lease restriction.

[¶18] To that end, "an HOA cannot create new affirmative obligations where the original declaration did not provide notice to the homeowners that they might be subject to such obligations." *Id.* at 538, ¶14, 506 P.3d at 24. Such notice relies on the reasonable expectations of purchasers based upon the language of the original declaration; therefore, "substantial, unforeseen, and unlimited amendments" that alter the nature of the covenants to which the homeowners originally agreed are invalid. *Id.* The original provision must give notice that a restrictive or affirmative covenant exists and that it could be "amended to refine it, correct an error, fill in a gap, or change it in a particular way." *Id.* at 539, ¶17, 506 P.3d at 25. However, "future amendments cannot be entirely new and different in character, untethered to an original covenant." *Id.*

[¶19] As noted above, the original Section 2.30 was very limited as to both restrictive and affirmative covenants:

(1) owners could not lease less than the entire lot; and

(2) upon leasing a lot, the owner was required to "promptly" notify the Association of the commencement date, termination date, and names of the lessees.

(*See* IRA 4 at p.5; APPX-1 at Sec. 2.30). Notably, the original Section 2.30

contained no temporal restriction upon leasing.

[¶20] To the extent the Amendment contains a temporal restriction upon leasing, such is clearly invalid under *Kalway* as it creates a restriction that is entirely new and different in character to anything in the prior Declaration. It is clear that Arizona law prohibits the imposition of entirely new and unforeseeable covenants under both *Kalway* and *Dreamland*. Arizona law does not allow community associations to enact such amendments through generic amendment provisions contained in their declarations absent unanimous consent. Here, the Association has amended the Declaration, justifying its actions by pointing to a general-amendment-power provision in Section 9.2 of the Declaration. The Amendment goes beyond the scope of what is allowable under Arizona law as it imposes entirely new covenants which were unforeseeable and not contemplated under the original Declaration language. Such amendments are invalid under Arizona law, a principle which has been recently affirmed by the highest court in this State.

C. <u>The intent of the Declaration was to allow leasing, even short-term leasing.</u>

[¶21] Ultimately, deed restrictions are contracts that should be construed to give effect to the intent of the parties. *Powell v. Washburn*, 211 Ariz. 553, 556, ¶9, 125 P.3d 373, 376 (2006) (*citing Arizona Biltmore Estates Ass'n v. Tezak*, 177 Ariz. 447, 448, 868 P.2d 1030, 1031 (App. 1993). While the *Kalway* analysis

focuses on foreseeability and notice to determine whether a general-amendment-power will allow the amendment, implicit in that analysis is that an unforeseen amendment changes the contract in a way that was not only unanticipated, but unagreed upon and contrary to the intent of the parties.

[¶22] As discussed above, vacationers and other short-term renters have been a mainstay of The Shores since the developer still owned and controlled the community. In fact, as noted by this Court in a prior appeal, the original developer and other owners have leased townhome units within The Shores, for periods as short as a few days, **since the 1990s**. *See Horton v. Hartsook*, No. 1 CA-CV 08-0095, 2009 WL 2244503 at ¶4. Common sense suggests that the Amendment was far from foreseeable.

[¶23] Because the deed restrictions must be construed in a way that comports with the original intent of the drafter (*i.e.*, the developer), the history **that has already been noted by this Court in *Horton v. Hartsook*** is critical to the intent analysis and informs the foreseeability analysis under *Kalway*. In fact, it makes sense why the Declaration did not prohibit short-term rentals as it would have been contrary to the business[10] of the developer. Against this backdrop, it

[10] Interestingly, this fact also refutes the Association's tortured argument concerning whether a rental is a business or a lease of a residence. In addition to the fact that this Court already rejected such reasoning in *Village of Oakcreek Ass'n v. Bonham, supra*, the intent under the Declaration must have been to exclude from the definition of a prohibited business all rentals of any duration.

would not be foreseeable for the general-amendment-power provision of the Declaration to be used to impose a short-term rental restriction where no temporal restriction ever existed, particularly in a development where the developer was engaged in short-term rentals for decades. To construe the Declaration otherwise, given the developer's historical short-term rentals, would result in an absurdity that this Court must avoid. *See Roe v. Austin*, 246 Ariz. 21, 27, ¶17, 433 P.3d 569, 575 (App. 2018) ("court must avoid an interpretation of a contract that leads to an absurd result").

D. The Association's "nuisance abatement" arguments are not enough to avoid *Kalway*.

[¶24] Finally, the Association argues that the short-term rental restriction is valid because the Declaration provides notice that the Association can impose fines in response to nuisances and can ban business activities that constitute a nuisance. (Op. Br. at p.41). Even if the Court were to consider these arguments that were not raised below for the first time on appeal, *Hawkins v. Allstate Ins. Co.*, 152 Ariz. 490, 503, 733 P.2d 1073, 1086 (1987), they should be rejected as it would create an exception to the foreseeability analysis that would swallow the entirety of the rule and language of the Declaration along with it.

[¶25] First, the fact that the Association may have the general power to

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Otherwise, the developer would have been in breach of the covenants and restrictions that the developer had drafted.

penalize owners who allow activity that constitutes "nuisance through noise, firecrackers, dangerous activities, and potential threats to the health, safety, and welfare of the community" (Op. Br. at p.41) does not grant upon the Association the authority to ***ban*** the activity if doing so is unreasonable. Moreover, ***penalty*** is not synonymous with ***prohibition***. In fact, to the extent the Association has the ability to penalize when certain activities create a nuisance through things like noise necessarily assumes that the activity, itself, is permitted in the first instance.

[¶26] Second, residential rentals (regardless of duration) are not "business activity" because leasing of residences is exempted from the definition of business activity under Section 2.18. Therefore, it would be unforeseeable to utilize the Association's ability under Section 2.18 to find certain business activities a "nuisance" to then prohibit an activity that the Declaration expressly excludes from the definition of a business activity in the first place.

[¶27] Third, if the "nuisance" regulation power of the Association is as unfettered as the Association would have this Court believe, then *Kalway* and the basic common law of contracts would be rendered meaningless. If the Association had its way, it could simply determine that anything the majority does not like is a "nuisance" in some way and then prohibit that activity even if completely unforeseeable. The power of "nuisance" regulation does not extend that far. In fact, the Supreme Court rejected this sort of reasoning in *Kalway*, which invalidated an

amendment that required owners to clear "dried undergrowth" and "deadwood." 252 Ariz. at 542, ¶41, 506 P.3d at 28. The Supreme Court reasoned that, while the provision was likely "advisable to prevent wildfires," because there was no such requirement in the original declaration, there was insufficient notice to impose the same with a general-amendment-power provision. *Id.*

[¶28] Whether it is advisable to preclude short-term rentals is dubious. Whether fire prevention is more advisable than short-term rentals is obvious. But it does not matter under *Kalway*.

V. CONCLUSION

[¶29] For the reasons stated, the Homeowners respectfully request that this Court affirm the trial court's finding that subsection (A) of the Amendment is invalid and must be stricken. Additionally, the Homeowners respectfully request an award of attorneys' fees and costs incurred below and on appeal pursuant to the Declaration and A.R.S. §§ 12-341, -341.01 subject to their compliance with *ARCAP* Rule 21.

OPENING BRIEF ON CROSS-APPEAL

I. INTRODUCTION

[¶30] Although the trial court correctly found that the short-term rental restriction in subsection (A) of the Amendment was invalid under *Kalway*, it misapplied that case with respect to subsection (B). As discussed below, the Amendment used the phrase "Single Family," which was previously only used to impose a ***use*** restriction requiring all development to be for "Single Family residential use" (in other words, homes and not multi-family or commercial), to impose an ***occupancy*** restriction. Moreover, the Amendment sought to change the definition of the term "Single Family" solely for purposes of Section 2.30 (and not for any other portion of the Declaration). The Amendment fails under *Kalway* for two reasons: (1) the occupancy restriction was entirely new and untethered to any prior restriction; and (2) changing the definition of "Single Family" solely for purposes of Section 2.30 could not be foreseen as that definition never existed in Section 2.30 and would not apply to any other portion of the deed restrictions (thus creating two different meanings for "Single Family" within the same document where only one meaning existed before). The trial court's ruling as to subsection (B) of the Amendment should therefore be reversed.

[¶31] The trial court also erred by refusing to award attorneys' fees and costs to the Homeowners. As discussed in the court below and as this Court has likely

gleaned from the briefing, the war was over the short-term rental restriction. The Homeowners' complaint was directed, not just primarily, but ***solely*** at the offensive and invalid nature of the short-term rental restriction. The summary judgment briefing, while addressing other portions of the Amendment in passing, was directed at the short-term rental restriction. The Association's Opening Brief, consistent with the principle objective of this litigation, addresses short-term rentals (both why that portion of the Amendment should stand and the Association's purported power to regulate short-term rentals). This case was all about short-term rentals. The Homeowners prevailed on that issue.

[¶32] Another way that the law is called upon, in a contract setting, to protect the powerless from the powerful is through fee-shifting. Here, the Homeowners (a mere 9 Davids) took on Goliath. And they won. If fees are not awarded here, where the Association acted in contravention of clear Arizona law, there is both a chilling effect on future Davids and an emboldening of future Goliaths. Discretion should be exercised to accomplish justice, which was denied when fees were denied. For these reasons and those below, this Court should reverse the trial court's denial of attorneys' fees and costs.

II. STATEMENT OF ISSUES

[¶33] Did the trial court err by finding that subsection (B) of the Amendment imposing a "Single Family" occupancy restriction is valid under *Kalway*?

[¶34] Did the trial court abuse its discretion by denying an award of attorneys' fees and costs to the Homeowners even though Homeowners succeeded in invalidating the short-term rental restriction, which was the objective of the litigation?

III. STANDARD OF REVIEW

[¶35] This Court reviews an order granting a motion for summary judgment *de novo*. *Pi'Ikea, LLC v. Williamson*, 234 Ariz. at 285, ¶ 5, 321 P.3d at 450 (App. 2014). An award of attorneys' fees is generally reviewed for abuse of discretion. *Nolan v. Starlight Pines Homeowners Ass'n*, 216 Ariz. 482, 490, ¶34, 167 P.3d 1277, 1285 (App. 2007). However, issues of statutory construction involving entitlement to fees and the court's authority to award fees are reviewed *de novo*. *See 4501 Northpoint LP v. Maricopa County*, 212 Ariz. 98, 100, ¶9, 128 P.3d 215, 217 (2006); *Camelback Plaza Dev., L.C. v. Hard Rock Café Int'l, Inc.*, 200 Ariz. 206, 208, ¶4, 25 P.3d 8, 10 (App. 2001).

[¶36] "Judicial discretion is abused when a trial court's ruling is clearly against the logic of the circumstances …" *Jezewak v. Jezewak*, 3 S.W.3d 860, 865 (Mo. App. 1999). Appellate courts will substitute their judgment for that of the trial judge if the trial court's action is "clearly untenable, legally incorrect, or amount to a denial of justice." *State v. Chapple*, 135 Ariz. 281, 297, n. 18, 660 P.2d 1208, 1224 (1983).

IV. LEGAL ARGUMENT

A. Section 2.30(B) of the Amendment concerning "Single Family" is invalid under *Kalway*.

1. The Declaration did not contain an occupancy restriction.

[¶37] As set forth above in the Answering Brief, Section 2.30 of the Declaration does not contain any restriction as to *whom* can rent:

> **2.30 Leasing of Lots**. No Owner may lease less than his entire Lot. Upon leasing his Lot, an Owner shall promptly notify the Association of the commencement date and termination date of the lease and the names of each lessee or other person who will be occupying the Lot during the term of the Lease.

(APPX-1 at Sec. 2.30). Although Section 2.18 of the Declaration requires that lots be "used, improved and devoted exclusively to Single Family residential use," the term "Single Family" (defined in Section 1.47) was used to describe the ***use*** of the property (*i.e.*, single-family homes as opposed to multi-family housing or commercial structures); the term "Single Family" was not used to describe who could ***occupy*** a home.

[¶38] The Amendment deleted the existing Section 2.30 and replaced it as follows (pertinent language emphasized below):

> **2.30. Leasing of Lots.**
>
> (A) After December 31st, 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 purposes 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.***

(APPX-2).

[¶39] As noted above, "an HOA cannot create new affirmative obligations where the original declaration did not provide notice to the homeowners that they might be subject to such obligations." *Kalway*, 252 Ariz. at 538, ¶14, 506 P.3d at 24. Such notice relies on the reasonable expectations of purchasers based upon the language of the original declaration; therefore, "substantial, unforeseen, and unlimited amendments" that alter the nature of the covenants to which the homeowners originally agreed are invalid. *Id.* The original provision must give notice that a restrictive or affirmative covenant exists and that it could be "amended to refine it, correct an error, fill in a gap, or change it in a particular way." *Id.* at 539, ¶17, 506 P.3d at 25. However, "future amendments cannot be entirely new and different in character, untethered to an original covenant." *Id.*

[¶40] The Amendment at subsection (B) creates an ***occupancy*** restriction where there was previously only a ***use*** restriction. Therefore, this portion of subsection (B) is a new restriction that never existed, is substantial and unforeseen, and does not correct an error or fill in a gap. Rather, it is an entirely new restriction untethered to the original Declaration. Therefore, it is invalid under *Kalway.*

[¶41] Presumably, the Association will argue that "Single Family" was in

the original Declaration as part of the use restrictions under Section 2.18. However, an occupancy restriction is ***not*** the same as a use restriction as discussed in a case that was, coincidentally, cited by the Association in its Opening Brief. *See Tarr v. Timberwood Park Owners Ass'n*, 556 S.W.3d 274, 286-87 (Tex. 2018) (noting distinction between "single-family dwelling" use restriction and "single-family occupancy requirement") (quoting *Permian Basin Centers for Mental Health & Mental Retardation v. Alsobrook*, 723 S.W.2d 774, 776 (App. Tx. 1986)). There is nothing in the Declaration that would put the Homeowners on notice that the Single Family ***use*** restriction could be amended to impose an ***occupancy*** restriction.

2. Kalway does not permit an amendment to change the definition of "Single Family" only with respect to one section and not the remainder of the Declaration.

[¶42] The Declaration requires that all lots be used, improved, and devoted exclusively to Single Family residential use. (APPX-1 at Sec. 2.18). The Declaration defines "Single Family" as, "a group of one or more persons each related to the other by blood, marriage or legal adoption, or a group of persons not all so related, who maintain a common household in a Residential Unit." (APPX-1 at Sec. 1.47). In upholding the subject portion of subsection (B) of the Amendment, the trial court reasoned that, because lots had to be devoted to Single Family residential use, and because "Single Family" was defined at Section 1.47,

the Homeowners were on notice that the term "Single Family" could be redefined or amended in the future with respect to leasing. Therefore, according to the trial court, the Amendment, which put a cap on the number of unrelated people who could constitute a household unit for purposes of a “Single Family.”

[¶43] Unfortunately, the trial court did not appreciate the distinction between “use” and “occupancy” restrictions discussed in the preceding section. Regardless, by imposing a cap on unrelated people who constitute a “Single Family” in the Amendment, the Amendment is effectively a redefinition of “Single Family” only for purposes of leasing. It is likely that the Association changed the definition of “Single Family,” only as to leasing under the Amendment, because the Association recognizes that “Single Family” is truly only intended to modify the phrase “residential use” under Section 2.18.

[¶44] In any event, an amendment that effectively redefines an already defined term, relied upon by the Homeowners, and only applies to *one provision* of a 52-page Declaration is hardly foreseeable under *Kalway*. Redefining an already defined term, a definition relied upon by all the Homeowners when they purchased their homes, does not fall within the limits articulated by our Supreme Court.

[¶45] In *Kalway*, the Supreme Court considered whether an amendment to the declaration that limited the types and quantities of permitted "livestock" was valid. The amendment in that case had limited "livestock" to "chickens, horses, and

cattle only," as well as limiting the total number of livestock units to fifteen despite the original declaration only limiting livestock units to no more than six per 3.3 acres and defined livestock as including, but not limited to, horses and cattle. Because it was unclear what "livestock" was intended to mean under the original declaration, the *Kalway* Court looked to both dictionary definitions of livestock and the context in which livestock was used in the original declaration. After reviewing both, the court determined that, given the livestock number limitation relative to the lots, and the mention of large livestock like horses and cattle, that a reasonable landowner might have interpreted "livestock" as meaning only large animals like horses and cattle. Such being the case, reasonable landowners might have believed that the original declaration was silent regarding smaller animals, like chickens.

[¶46] The Supreme Court held that redefining "livestock" to include animals that might reasonably have been understood by owners not to be subject to the number limitations imposed by the original declaration in connection with large livestock like horses or cattle was ***impermissible*** under Arizona law because it would not be reasonably foreseeable and would unreasonably alter the nature of the original declaration. Here, prior to the Amendment, 5 or more unrelated persons would have fallen within the definition of "Single Family" but for the new cap, which never existed before, on unrelated persons maintaining a common

household *solely for the purposes of leasing*. This, like the attempted amendment to limit the number of chickens permitted on a lot in *Kalway,* was not reasonably foreseeable to the Homeowners at the time they purchased their homes and, therefore, the Amendment unreasonably alters the nature of the original declaration and covenants by now prohibiting activity that would previously, and clearly, permitted.

[¶47] For these reasons, the Homeowners request that this Court reverse the trial court's ruling as to subsection (B) of the Amendment and direct that judgment be entered in favor of the Homeowners redlining the Amendment as follows:

> (B) No portion of a Lot may be leased, other than the entire Lot~~, and then only to a Single Family. For purposes 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~~.

B. <u>The trial court should have awarded attorneys' fees to the Homeowners.</u>

[¶48] The Homeowners requested an award of their attorneys' fees pursuant to both A.R.S. §12-1103(B) and §12-341.01(A). Under A.R.S. §12-1103(B), the prevailing party in a quiet title action may be awarded attorneys' fees and costs provided that the party complied with the statute (which is not in dispute in this matter). *Cook v. Grebe*, 245 Ariz. 367, 369, 429 P.3d 1161, 1163 (App. 2018). The trial court denied the Homeowners' request without explanation. To the extent that the trial court was exercising its discretion to deny fees (rather than

misunderstanding the statutory authority for doing so), the trial court abused its discretion. The fee-shifting under the quiet title statute exists so that property owners are not forced to incur the cost of removing clouds and encumbrances on title that should not exist. The quiet title statute balances the policy in favor of non-judicial resolution as it requires the party to first send a demand, a quitclaim deed to invalidate the offending instrument, and five dollars for the trouble, all before allowing the lawsuit to be filed. To deny fees results in a denial of justice. *See State v. Chapple*, 135 at 297, n. 18, 660 P.2d at 1224.

1. The Homeowners were the prevailing party under either A.R.S. §12-341.01 or §12-1103.

[¶49] In quiet title actions, the determination of who is the prevailing party turns on whether a party successfully quieted title, regardless of whether claims that do not involve quieting title are included in the same lawsuit. *Cook v. Grebe*, *supra* (citations omitted).

[¶50] In *Cook*, the party objecting to the award of fees argued that the superior court had erred in finding that the other party was the prevailing party because "he prevailed on a greater number of claims than she did" *Id* at ¶7. While the Homeowners and the Association were both granted partial summary judgment on the same counts, and setting aside that the Association should not prevail on the "Single Family" portion of subsection (B), the Association will likely argue that it prevailed on a greater number of sub-parts of the Amendment and, therefore,

should be considered the prevailing party. As *Cook* explains, determination of success hinges on whether title was quieted, not the number of subparts or claims prevailed on. Here, it is indisputable that Homeowners have quieted title to their property through the invalidation of the chief issue in this dispute: the short-term rental prohibition contained in the Amendment. As this Court held in *Cook*:

> [T]he superior court did not abuse its discretion in finding she [Grebe] was the prevailing party with regard to the attorneys' fee provision of § 12-1103(B). Contrary to Cook's assertion, the court had no reason to look further than the quiet title and adverse possession claims because they are the only claims in this lawsuit that involved quieting title to the property.

Id at ¶9. Similarly, the Court need not look further than the quiet title claim in this case in determining whether Homeowners were the prevailing party. For the Homeowners to be considered the prevailing party, they need only have achieved their primary objective by quieting title.

[¶51] In determining who has prevailed, Arizona courts look to determine who has achieved (or failed) in their "principal effort" in the litigation. *Ahwatukee Custom Estates Mgmt Ass'n v. Turner*, 196 Ariz. 631, 637, ¶22, 2 P.3d 1276, 1283 (App. 2000). As noted above, Homeowners achieved their primary objective: invalidating the short-term rental prohibition contained in the Amendment and thereby quieting title. The pleadings evidence that invalidating the short-term rental restriction was the primary objective of the Homeowners as the Complaint

and First Amended Complaint are both expressly focused upon the short-term rental restriction. (*See* IRA 1 at ¶¶ 32-33, 35-41, 48-51, 56-58, 63-64, 71, 73, and 83; *see also* IRA 27).

[¶52] Furthermore, under Arizona law, the Court may consider the "totality of the litigation" *Am. Power Prods. V. CSK Auto, Inc.*, 241 Ariz. 564, 390 P.3d 804 (2017); *Schwartz v. Farms Ins. Co. of Ariz.*, 166 Ariz. 33, 800 P.2d 20 (App. 1990); *Nataros v. Fine Arts Gallery of Scottsdale, Inc.*, 126 Ariz. 44, 612 P.2d 500 (App. 1980). Here, the totality of the litigation also weighs in favor of awarding the Homeowners their fees. After giving the Association the opportunity to withdraw the Amendment without resorting to litigation (in compliance A.R.S. §12-1103), the Homeowners obtained a stipulation from the Association to not enforce the Amendment pending the outcome of litigation. This mooted virtually all of the Homeowners' money damages.

2. Other factors supporting an award of fees.

[¶53] In addition to the above, courts should consider the *Associated Indemnity* factors set forth by the Supreme Court. *Scottsdale Memorial Health Sys. v. Clark*, 164 Ariz. 211, 215, 791 P.2d 1094, 1098 (App. 1990). Those factors are:

> (1) the merits of the claim or defense presented by the unsuccessful party;
>
> (2) the litigation could have been avoided or settled and the successful party's efforts were completely superfluous in achieving the result;

> (3) assessing fees against the unsuccessful party would cause an extreme hardship;
>
> (4) the successful party did not prevail with respect to all of the relief sought;
>
> (5) the novelty of the legal question presented and whether such claim or defense had previously been adjudicated in this jurisdiction; and
>
> (6) whether the award would discourage other parties with tenable claims or defenses from litigating or defending legitimate contract issues for fear of incurring liability for substantial amounts of attorneys' fees.

Associated Indem. Corp. v. Warner, 143 Ariz. 567, 570, 694 P.2d 1181, 1184 (1985).

[¶54] These factors weigh in favor of awarding Homeowners their fees: (1) the merits of the Association's positions are non-existent in the face of *Kalway* and its persistence in arguing as if *Kalway* does not apply should weigh against it; (2) the litigation could have been avoided entirely had the Association simply complied with the Homeowners' quiet title request that was made before the initiation of the lawsuit, which clearly stated well-settled Arizona law that rendered the short-term rental restriction invalid; (3) assessing fees against the Association is more just than forcing the Homeowners to incur the fees to invalidate something that should not have ever been recorded; (4) the Homeowners prevailed on their primary objective: invalidating the short-term rental ban, and to the extent that they

sought money damages, those claims were mooted due to the Association's early stipulation to delay enforcement (in effect, a victory); (5) the issues presented in the case were not novel because, for over a decade before *Kalway*, Arizona law held that unforeseeable modifications to a community declaration were not valid under *Dreamland Villa v. Raimey*, 224 Ariz. 42, 226 P.3d 411 (App. 2010); and (6) denying the Homeowners fees here would discourage other property owners from seeking to invalidate unlawful amendments to their community documents.

[¶55] For policy reasons, an award of fees would perhaps encourage other homeowners associations to reconsider their actions that deprives property rights without the consent of all residents in the association.

V. CONCLUSION

[¶56] For the reasons stated, the Homeowners respectfully request that this Court: (a) reverse the trial court's denial of attorneys' fees and costs; (b) reverse its findings as to subsection (B) of the Amendment; and (c) direct the trial court to redline the Amendment as follows:

> (B) No portion of a Lot may be leased, other than the entire Lot~~, and then only to a Single Family. For purposes 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~~.

Additionally, the Homeowners respectfully request an award of attorneys' fees and costs incurred below and on appeal pursuant to the Declaration and A.R.S.

§§ 12-341, -341.01 subject to their compliance with *ARCAP* Rule 21.

RESPECTFULLY SUBMITTED this 27th day of October, 2023.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 14, Arizona Rules of Civil Appellate Procedure, I certify that the attached Combined Answering Brief and Opening Brief on Cross-Appeal uses proportionately spaced type of 14 points, is double-spaced (aside from headings, footnotes, and quotations), uses Times New Roman font, and contains 7,421 words, not including the Table of Contents, Table of Authorities, Certificate of Service, and Certificate of Compliance.

RESPECTFULLY SUBMITTED this 27th day of October, 2023.

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