

SECTION A – TENNESSEE LAW

Function of HOA

The purpose of common-interest communities or HOAs is to ensure the collective rights and interest of homeowners. HOA's are governed by board of directors that is established to guide governance and direct actions in the best interest of all residents.

Generally, HOA's provide:

- Cultivation of a strong sense of community through a culture of consensus building,
- Encouragement of active homeowner participation to ensure that the collective rights and interests of homeowners are respected and preserved,
- Services and amenities to residents,
- Care and upkeep of common areas, and
- Protection of property values.

At the outset, HOA's are established and managed by the developer during the time period when the subdivision is under development. Generally, at some point in time, when homeowners own more of the subdivision property (e.g., lot, unit, home) than the developer, then the HOA transitions from a developer-directed HOA to a homeowner-directed HOA.

HOA's – Nonprofit Corporations

In Tennessee, HOA's are usually incorporated as nonprofit corporations, and therefore subject to Tennessee Nonprofit Corporation Act (TCA 48-51-101, *et. seq.*). According to *What Every Board Member Should Know, A Guidebook for Tennessee Nonprofits, 2019 Edition*, published by the Tennessee Attorney General and Reporter, Secretary of State, and Center for Nonprofit Management nonprofits corporations can be divided into two categories – public benefit or mutual benefit. HOAs are considered the later (See Section B).

See Exhibit I – Tennessee Nonprofit Corporation Act (TCA 48-51-101, *et. seq.*)

SECTION B – MEMBERSHIP

Mutual Benefit Nonprofit Corporations Under Tennessee Law

Tennessee law describes HOA's as mutual benefit nonprofit corporations, which is a type of nonprofit corporation that is sometimes referred to as a "membership corporation". As its name indicates, this type of corporation is formed to serve the mutual interests of its members for common gain organizations like community financial institutions, managing common property (e.g., homeowner associations), and trade groups or professional organization. (See excerpt below.)

2010 Tennessee Code

Title 48 - Corporations and Associations

Chapter 68 - Transition Provisions

Part 1 - General Provisions

48-68-104 - Public benefit and mutual benefit corporations.

On January 1, 1988, each domestic corporation existing on January 1, 1988, that is or becomes subject to chapters 51-68 of this title, shall be designated as a public benefit or a mutual benefit corporation as follows:

(1) Any corporation designated by statute as a public benefit corporation or a mutual benefit corporation is the type of corporation designated by statute;

(2) Any corporation which does not come within subdivision (1) but which is recognized as exempt under § 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)), or any successor section, is a public benefit corporation;

(3) Any corporation which does not come within subdivision (1) or (2), but which is organized for a public or charitable purpose and which upon dissolution must distribute its assets to the United States, a state or a person which is recognized as exempt under § 501(c)(3) of the Internal Revenue Code, or any successor section, is a public benefit corporation; and

(4) Any corporation which does not come within subdivision (1), (2) or (3) is a mutual benefit corporation.

[Acts 1987, ch. 242, § 18.06.]

SECTION C – BOARD OF DIRECTORS

Under Tennessee law (Tennessee Nonprofit Corporation Act [TCA 48-51-101, *et. seq.*]), each corporation must have a board of directors to govern its actions and activities. Tennessee nonprofit corporations must have at least three board members, and must have officers, including a president and secretary, that must be different persons.

Tennessee has certain minimum requirements with respect to nonprofit officers and board members. The following checklist will help to ensure that the HOA is in compliance with these requirements. The requirements include:

- Enforcing provisions of the declaration, articles, and bylaws for the ownership and management of the development;
- Paying taxes and assessments that are, or could become, a lien on the common area;
- Contracting for insurance on behalf of the association;
- Contracting for goods or services for the common areas or for the association;
- Delegating powers to any committees, officers, or employees of the association as authorized by the governing documents;
- Preparing budgets and financial statements for the association;
- Formulating rules of operation for the common areas and facilities; and
- Conducting disciplinary proceedings against members of the association for rule violations.

The following pages include selected excerpts from the Tennessee Nonprofit Corporation Act that provide guidance as to the requirements for the board of directors. The included sections listed below are not intended to be an all-inclusive as to board requirements under the law; however, intended as a listing of key sections.

- 48-58-101. Requirement for and duties of board of directors.
- 48-58-103. Number of directors.
- 48-58-104. Election, designation, and appointment of directors.
- 48-58-302. Director and officer conflict of interest.
- 48-58-401. Required officers.
- 48-58-403. Standards of conduct for officers.

48-58-101. Requirement for and duties of board of directors. —

(a) Each corporation must have a board of directors.

(b) Except as provided in chapters 51-68 of this title or subsection (c), all corporate powers shall be exercised by or under the authority of, and the affairs of the corporation managed under the direction of, its board.

(c) The charter may authorize a person or persons to exercise some or all of the powers which would otherwise be exercised by a board. To the extent so authorized, any such person or persons shall have the duties and responsibilities of the directors, and the directors shall be relieved to that extent from such duties and responsibilities. [Acts 1987, ch. 242, § 8.01.]

48-58-103. Number of directors. —

(a) A board of directors must consist of three (3) or more natural persons, with the number specified in or fixed in accordance with the charter or bylaws.

(b) The number of directors may be increased or decreased (but to no fewer than three (3)) from time to time by amendment to, or in the manner prescribed in, the charter or bylaws. [Acts 1987, ch. 242, § 8.03.]

48-58-104. Election, designation, and appointment of directors. —

(a) If the corporation has members, all directors (except the initial directors) shall be elected at the first annual meeting of members, and at each annual meeting thereafter, unless the charter or bylaws provide some other time or method of election or provide that some of the directors are appointed by some other person or designated.

(b) If the corporation does not have members, all directors (except the initial directors) shall be elected, appointed or designated as provided in the charter or bylaws. If no method of designation or appointment is set forth in the charter or bylaws, the directors (other than the initial directors) shall be elected by the board. [Acts 1987, ch. 242, § 8.04; 1988, ch. 610, § 1; 1993, ch. 412, § 1.]

48-58-302. Director and officer conflict of interest. —

(a) A conflict of interest transaction is a transaction with the corporation in which a director or officer of the corporation has a direct or indirect interest. A conflict of interest transaction is not voidable or the basis for imposing liability on the director or officer if the transaction was fair at the time it was entered into or is approved as provided in subsection (b).

(b) A transaction in which a director or officer of a corporation has a conflict of interest may be approved if:

(1) The material facts of the transaction and the director's or officer's interest were disclosed or known to the board of directors or a committee consisting entirely of members of the board of directors and the board of directors or such committee authorized, approved, or ratified the transaction;

(2) The material facts of the transaction and the director's or officer's interest were disclosed or known to the members and they authorized, approved, or ratified the transaction; or

(3) Approval is obtained from:

(A) The attorney general and reporter; or

(B) A court of record having equity jurisdiction in an action in which the attorney general and reporter is joined as party.

(c) For the purposes of this section, a director or officer of the corporation has an indirect interest in a transaction if, but not only if:

(1) Another entity in which the director or officer has a material interest or in which the director or officer is a general partner is a party to the transaction; or

(2) Another entity of which the director or officer is a director, officer, or trustee is a party to the transaction.

(d) For purposes of subsection (b), a conflict of interest transaction is authorized, approved, or ratified, if it receives the affirmative vote of a majority of the directors on the board or on the committee consisting entirely of members of the board of directors, who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors on the board who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any action taken under subdivision (b)(1) if the transaction is otherwise approved as provided in subsection (b).

(e) For purposes of subdivision (b)(2), a conflict of interest transaction is authorized, approved, or ratified by the members if it receives a majority of the votes entitled to be counted under this subsection. Votes cast by or voted under the control of a director who has a direct or indirect interest in the transaction, and votes cast by or voted under the control of an entity described in subdivision (c)(1), may not be counted in a vote of members to determine whether to authorize, approve, or ratify a conflict of interest transaction under subdivision (b)(2). The vote of these members, however, is counted in determining whether the transaction is approved under other sections of chapters 51-68 of this title. A majority of the voting power, whether or not present, that is entitled to be counted in a vote on the transaction under this subsection constitutes a quorum for the purpose of taking action under this section.

(f) The charter, bylaws, or a resolution of the board may impose additional requirements on conflict of interest transactions. [Acts 1987, ch. 242, § 8.31.]

48-58-401. Required officers. —

(a) A corporation has the officers described in its bylaws or designated by its board of directors in accordance with the bylaws; provided, that every corporation shall have a president and a secretary. Unless the charter or bylaws provide otherwise, officers shall be elected or appointed by the board of directors.

(b) A duly appointed officer may appoint one (1) or more officers or assistant officers if authorized by the bylaws or the board of directors.

(c) The bylaws or the board of directors shall delegate to one (1) of the officers responsibility for preparing minutes of the directors' and members' meetings and for authenticating records of the corporation.

(d) The same individual may simultaneously hold more than one (1) office in a corporation, except the offices of president and secretary. [Acts 1987, ch. 242, § 8.40; 1989, ch. 445, § 7.]

48-58-403. Standards of conduct for officers. —

(a) An officer with discretionary authority shall discharge all duties under that authority:

- (1) In good faith;*
- (2) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and*
- (3) In a manner the officer reasonably believes to be in the best interests of the corporation.*

(b) In discharging such duties, an officer is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:

- (1) One (1) or more officers or employees of the corporation whom the officer reasonably believes to be reliable and competent in the matters presented; or*
- (2) Legal counsel, public accountants, or other persons as to matters the officer reasonably believes are within the person's professional or expert competence.*

(c) An officer is not acting in good faith if the officer has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) An officer is not liable for any action taken as an officer or any failure to take any action, if the officer performed the duties of office in compliance with this section. [Acts 1987, ch. 242, § 8.42.]

SECTION D – FIDUCIARY DUTIES

Legal Duties of Board Members

In Tennessee, board members owe a legal duty to the nonprofit organizations they serve, and as such have fiduciary duties that are required by law. Black's Law Dictionary defines a "fiduciary duty" as *"a duty to act for someone else's benefit, while subordinating one's personal interests to that of the other person."* A fiduciary is an individual in whom the utmost trust and confidence has been placed by another to manage and protect property or money. This applies to HOA boards (as mutual benefit nonprofit corporations) that are entrusted with the Association's property, money, and general safety of the community.

Acting as a "fiduciary" is the highest standard of duty implied by law (e.g., trustee, guardian). Under Tennessee law, nonprofit corporations are required to adhere to the fiduciary duties listed below.

- **Duty of Good Faith**

Board members have duty to be faithful to the organization's purpose and mission; adhere to the organization's governing documents and board direction; ensure that its funds are used for lawful purposes; and abide by state and federal laws and regulations that relate to the organization and its operations. This means that board members must act in good faith and be fair in their dealings. In other words, board member must be upfront and honest in their dealings with the organization.

- **Duty of Loyalty**

Board members are required to be faithful to the interest of the organization and its objectives take precedence over a board member's personal interests or those of family or friends. This means that board members are required to act in a manner that they believe to be in the best interests of their nonprofit organization, and they may not seek to benefit personally from the activities or resources of the nonprofit that they serve. In the event that a conflict between the interests of the nonprofit and that of a board member, board members must comply with Tennessee law in resolving this conflict. Actions that benefit a board member at the expense of the nonprofit organization are a breach of the board member's fiduciary duties under the law.

- **Duty of Care**

Board members must exercise due care in all dealings. This means that a board member is required to act reasonably, as a prudent person in similar circumstances would behave. This includes development of policy direction, careful oversight of executive director and financial matters, being well-informed, and participating regularly in board meeting; and identifying and monitoring potential issues.

Avoiding Potential Conflicts of Interest

Whether the board of directors is under the direction of a developer or homeowners, it has fiduciary duties to homeowners under the law, and must at all times represent and protect the interests of homeowners. Under Tenn. Code §48-58-703, a director or officer must disclose potential conflicts consistent with the requirements of the law to avoid conflicts of interest. Under Tenn. Code §48-58-703(b), a conflict occurs when a director or officer has a "material financial interest" in the transaction or a "material relationship".

- **"Material Financial Interest:** means a financial interest in a transaction that would reasonably be expected to impair the objectivity of the director's or officer's judgment when participating in action on the authorization of the transaction." (Tennessee Code §48-58-701).
- **"Material Relationship:** means a familial, financial, professional, employment or other relationship that would reasonably be expected to impair the objectivity of the director's judgment when participating in the action to be taken." (Tennessee Code §48-58-701).

"A director or officer who has a conflicting interest respecting the transaction;"— OR — Under Tenn. Code §48-58-703(c)(3)(B) "A related person of the director or officer" may have a conflict that could result in relief, damage award, or sanctions (Tenn. Code §48-58-703(c)(3)(A)). This means that if fiduciary duties are breached knowingly or through neglect, Board members and officers may be held personally liable to the nonprofit for the harm it suffers from the break adherence to the law. (Tennessee Code §48-58-302 – Personal liability of director — Enforcement). However, as long as board members understand their responsibilities and avoid conflicts of interest, they will be following the law.

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SECTION E – RECORD REQUIREMENTS

HOA Record Keeping Requirements Under Tennessee Law

It is the responsibility of the board of directors to keep detailed records on file at the office of the nonprofit corporation. Under Tennessee law, corporate records should include:

- Minutes of all meetings and actions for the board and its committees for the past three years;
- Records of board member actions taken without meeting;
- Accounting and financial records, including the annual financial statements submitted to the Secretary of State;
- Record of members including names in alphabetical order, addresses, and number of votes allocated;
- The charter and all amendments currently in effect;
- The bylaws and all amendments currently in effect;
- Board resolutions relating to any class or category of members;
- Any written communication to the members for the last three years; and
- The names and business or home addresses for current officers and directors.

These records should be made available to association members during business hours within five (5) days of written request.

Excerpts from Tennessee Code

48-66-101. Corporate records.

(a) A corporation shall keep as permanent record minutes of all meetings of its members and board of directors, a record of all actions taken by the members or directors without a meeting, and a record of all actions taken by committees of the board of directors in place of the board of directors as authorized by §48-58-206(d).

(b) A corporation shall maintain appropriate accounting records.

(c) A corporation or its agent shall maintain a record of its members in a form that permits preparation of a list of the names and addresses of all members, in alphabetical order by class showing the number of votes each member is entitled to vote.

(d) A corporation shall maintain its records in written form or in another form capable of conversion into written form within a reasonable time.

(e) A corporation shall keep a copy of the following records at its principal office:

- (1) Its charter or restated charter and all amendments to it currently in effect;*
- (2) Its bylaws or restated bylaws and all amendments to them currently in effect;*
- (3) Resolutions adopted by its board of directors relating to the characteristics, qualifications, rights, limitations and obligations of members or any class or category of members;*
- (4) The minutes of all meetings of members and records of all actions approved by the members for the past three (3) years;*
- (5) All written communications to members generally within the past three (3) years, including the financial statements furnished for the past three (3) years under §48-66-201;*
- (6) A list of the names and business or home addresses of its current directors and officers; and*
- (7) Its most recent annual report delivered to the secretary of state under §48-66-203.*

48-66-102. Inspection of records by members.

(a) Subject to §48-66-103(c), a member is entitled to inspect and copy, during regular business hours and at a reasonable location specified by the corporation, any of the records of the corporation described in §48-66-101(e) if the member gives the corporation a written demand at least five (5) business days before the date on which the member wishes to inspect and copy.

(b) A member is entitled to inspect and copy, during regular business hours and at a reasonable location specified by the corporation, any of the following records of the corporation if the member meets the requirements of subsection (c) and gives the corporation written notice at least five (5) business days before the date on which the member wishes to inspect and copy:

- (1) Excerpts from any records required to be maintained under §48-66-101(a), to the extent not subject to inspection under subsection (a);*
- (2) Accounting records of the corporation; and*
- (3) Subject to §48-66-105, the membership list.*

(c) A member may inspect and copy the records identified in subsection (b) only if:

- (1) The member's demand is made in good faith and for a proper purpose;*
- (2) The member describes with reasonable particularity the purpose and the records the member desires to inspect; and*
- (3) The records are directly connected with the purpose for which the demand is made.*

(d) *The right of inspection granted by this section may not be abolished or limited by a corporation's charter or bylaws.*

(e) *This section does not affect:*

- (1) *The right of a member to inspect records under §48-57-201 or, if the member is in litigation with the corporation, to the same extent as any other litigant; or*
- (2) *The power of a court, independently of chapters 51-68 of this title, to compel the production of corporate records for examination.*

48-66-201. Financial statements for members.

(a) *A corporation shall prepare annual financial statements, which may be consolidated or combined statements of the corporation and one (1) or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year and a statement of operations for the year. If the financial statements are prepared for the corporation on the basis of generally accepted accounting principles, the annual financial statements must also be prepared on that basis. On demand in the form of a document from a member, a corporation must furnish that member with its latest annual financial statements as set out in subsection (c).*

(b) *If annual financial statements are reported upon by a public accountant, the public accountant's report must accompany them. If not, the statements must be accompanied by the statement of the president or the person responsible for the corporation's financial accounting records:*

- (1) *Stating the president's or other person's reasonable belief as to whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and*
- (2) *Describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.*

(c) *A corporation shall deliver in the form of a document the annual financial statements to each requesting member within one (1) month after notice of the demand; provided, that with respect to the financial statements for the most recently completed fiscal year, the statements shall be delivered in the form of a document to the member within four (4) months after the close of the fiscal year.*

48-66-203. Annual report for secretary of state.

(a) *Each domestic corporation, and each foreign corporation authorized to transact business in this state, shall deliver to the secretary of state an annual report that sets forth:*

- (1) *The name of the corporation and the state or country under whose law it is incorporated;*
- (2) *The street address, including the zip code, of its registered office, the county in which the office is located, and the name of its registered agent at that office in this state;*

- (3) *The street address, including the zip code, of its principal office (and a mailing address such as a post office box if the United States Postal Service does not deliver to the principal office);*
- (4) *The names and business addresses, including the zip code, of its directors and principal officers; provided, that corporations which are exempt from the payment of income tax under § 501(c)(3) of the Internal Revenue Code (26 U.S.C. §501(c)(3)) and are currently operating shall not be required to comply with this subdivision (a)(4);*
- (5) *If a domestic corporation, a statement that the corporation is a public benefit corporation or a mutual benefit corporation;*
- (6) *If a foreign corporation, a statement whether the corporation, if it had been incorporated in this state, would be a public benefit or mutual benefit corporation;*
- (7) *If a domestic religious corporation, a statement to that effect; and*
- (8) *The federal employer identification number (FEIN) of the corporation, or its corporation control number as assigned by the secretary of state.*

(b) The information in the annual report shall be current as of the date the annual report is executed on behalf of the corporation. An annual report of a domestic corporation that sets forth a change of the principal office of the domestic corporation shall be deemed to be an amendment to the charter of the domestic corporation, and the domestic corporation shall not be required to take any further action to amend the charter of the domestic corporation under chapter 60 of this title with respect to such amendment. An annual report of a foreign corporation that sets forth a change of the principal executive office of the foreign corporation shall be deemed to be an amendment to the certificate of authority of the foreign corporation, and the foreign corporation shall not be required to take any further action to amend the certificate of authority of the foreign corporation under §48-65-104 with respect to such amendment. An annual report of a domestic or foreign corporation that sets forth a change of the registered office or registered agent of the domestic or foreign corporation shall be deemed to be a statement of change for purposes of §§48-55-102 and 48-65-108, respectively, and the domestic or foreign corporation shall not be required to take any further action under §§48-55-102 and 48-65-108, respectively, with respect to such change.

(c) Every corporation shall file the annual report with the secretary of state on or before the first day of the fourth month following the close of the corporation's fiscal year, or upon a date set by rule by the secretary of state, if a domestic corporation or a foreign corporation.

(d) The secretary of state shall make a report to the commissioner of revenue, by the fifteenth day of each month, of any and all new corporations that have been licensed or authorized to operate in the state during the preceding month, giving the name and address of each new corporation, foreign or domestic.

(e) The secretary of state shall furnish the commissioner of revenue, by the fifteenth day of each month, a list of all corporations that have surrendered their charters, have had their charters revoked, or have ceased to do business in the state during the preceding month.

SECTION F – GOVERNING DOCUMENTS

HOA Governing Laws and Documents

HOAs are governed by a hierarchy of laws and legal documents as summarized below.

- A. Federal, State, and Local Laws: Federal, state, and local laws establish the regulations and the mechanisms through which subdivisions are filed and corporations (HOAs) are formed. Generally, the higher the level of government, the greater the precedence. However, in some cases, laws may be written in such a way to defer to HOA governing documents.
- B. Declaration of Covenants, Conditions & Restrictions (CCR) (or Master Deed): The CCRs is a legally binding document that is officially recorded with land records in the county in which the common-interest subdivision is located and is frequently referred to as the "Master Deed" for the development. This means that the requirements apply to the land no matter who owns it. Each time it is changed it requires a vote of the members (affected property owners) and is filed at the county in the register of deeds (or recorder's office). The CCR contains the rights and responsibilities of each member and the responsibilities of the HOA to its members, including information about architectural restrictions, property use restrictions, property maintenance standards, and more. More specifically, the CCR:
- Defines the portions of the development owned by the individual owners and the property owned by the HOA (or common areas);
 - Creates interlocking relationship binding all owners and the HOA for the purposes of maintaining, governing and funding the development;
 - Establishes protective standards, restrictions, and obligations in areas ranging from architectural control to prohibitions on various activities;
 - Defines maintenance obligations for HOA and individual members;
 - Creates the administrative framework for the operation and management of the Association;
 - Provides the mechanism for financial support of the Association through assessments; and
 - Provides for a transition of control of the HOA from the developer to the owners.
- C. Articles of Incorporation: This document brings the corporation into existence and includes basic information about the HOA including the name of the association, its location, and

purpose. Additionally, this document indicates whether there will be a board of directors – and if so, the identity of the initial board.

D. Bylaws: The bylaws contain the formally adopted administration and management regulations for the HOA. The types of items included are:

- Requirements for membership in the community association,
- Requirements for membership meetings,
- Voting rights of member owners,
- Procedures for electing the board of directors and officers,
- General powers and duties of the board, and
- Provision for indemnification of officers and directors.

E. Rules and Regulations: These documents formalize and enact rules and regulations that are formally adopted by the Board, and provide greater detail for owners right and obligations, architectural guidelines, enforcement, and collection procedures, and rules for operation of association facilities. In other words – providing greater detail as to how the CC&Rs are interpreted and implemented, as listed below.

- A resolution is a motion that follows a set format and is formally adopted by the board of directors. Resolutions may enact rules and regulations or formalize other types of board decisions. There are four types of resolutions:
 - Policy Resolutions: These are resolutions that affect owner's' rights and obligations (e.g., common areas and recreational facilities rules, architectural guidelines, and enforcement procedures).
 - Administrative Resolutions: This type of resolution addresses the internal operations of the Association (e.g., operating procedures, collection procedures, and board meeting locations).
 - Special Resolutions: These are Association resolutions that state board decisions which apply a policy or rule to an individual situation (e.g., rule violations or lawsuit).
 - General Resolutions: This type of resolution applies to routine Association events (e.g., budget adoption or contract approval).

- The power of the board to enact rules and regulations is generally defined in the declaration and/or the bylaws. Sometimes, the board's right to enact rules is limited by the requirement that the members approve the rules. Resolutions should be kept in a Book of Resolutions.

Note: Draft documents are offered for review and consideration by Deerfield Resort homeowner, including the Declaration of Protective Covenants, Conditions, and Restrictions and Bylaws.