

IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
August 7, 2007 Session

**ISLAND BROOK HOMEOWNERS ASSOCIATION, INC. v. JANICE
AUGHENBAUGH**

**Appeal from the Circuit Court for Sumner County
No. 26112-C C.L. Rogers, Judge**

No. M2006-02317-COA-R3-CV - Filed October 5, 2007

The defendant had her house built in a restricted subdivision and began using it for operation of her fitness training business. The owners of the corporation that developed the neighborhood and constructed the defendant's house were also controlling members of the subdivision homeowners association's board of directors. The homeowners association filed suit to permanently enjoin the defendant from conducting her business out of her home upon grounds that such activity violated subdivision restrictions. In her answer and countersuit, the defendant argued that the homeowners association's controlling board members had waived the restrictions by certain actions during construction of her house. The defendant also filed a third party complaint against the development corporation and against the individual owners of the corporation for misrepresentation. Upon motions for directed verdict, the trial court granted the homeowners association's request for a permanent injunction and dismissed the defendant's countercomplaint against that entity. The trial court also dismissed the defendant's complaint against the individual owners by directed verdict, but denied the development corporation's motion for directed verdict. A jury then found the development corporation liable for misrepresentation. On appeal, we conclude that the trial court did not err in granting the homeowners association's motion for directed verdict or in failing to grant the development corporation's motion for directed verdict. However, we conclude that the trial court did err in granting the individual owners' motion for directed verdict. Accordingly, the judgment of the trial court is affirmed in part, reversed in part and the case is remanded.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Circuit Court Affirmed in Part and Reversed in Part; Cause Remanded

SHARON G. LEE, J., delivered the opinion of the court, in which HERSCHEL P. FRANKS, P.J., and D. MICHAEL SWINEY, J., joined.

John M. Cannon, Goodlettsville, Tennessee, for the appellant, Janice Aughenbaugh.

John Wesley Jones, Gallatin, Tennessee, for the appellees, Floyd Wilkson, Lori Atchley, and the appellant, Danflor Development, LLC.

Ronald B. Buchanan, Hendersonville, Tennessee, for the appellee, Island Brook Homeowners Association, Inc.

OPINION

I. Background

Janice Aughenbaugh, a professional personal fitness trainer, trained her clients in a garage at her Hendersonville home for many years. She decided to build a new house that would include a gym and contacted a real estate agent to assist her in locating a residential lot on which to build the house. The agent showed her a lot in Island Brook Subdivision, a real estate development located in Hendersonville. The subdivision was owned and developed by the appellant Danflor Development, LLC (hereinafter “Danflor Development”) which was solely owned by Dan Carlyle and the appellees, Lori Atchley and Frank Wilkinson. When the agent first showed her the lot, he advised Aughenbaugh that Island Brook Subdivision was a “highly restrictive” neighborhood. Aughenbaugh later agreed to purchase the lot.

At the closing on August 29, 2002, Aughenbaugh was given a copy of a document entitled “DECLARATION OF RESTRICTIVE COVENANTS FOR ISLAND BROOK SUBDIVISION ALL PHASES,¹” which included provisions stating that “[e]ach Lot shall be used only for private, single family residential purposes” and that “[n]o house or structure on any Lot may be used for any business or commercial purpose.” The declaration was signed by Atchley and Wilkinson, who, along with Carlyle, served as the board of directors of the Island Brook Homeowners Association, Inc., the entity responsible for maintaining the subdivision and insuring that all homeowners complied with all restrictions.

On October 2, 2003, Aughenbaugh entered into a contract with Danflor Development to build the house. Approximately one-third of the house consisted of an 1100-square-foot gym. Wilkinson, a building contractor, who, as noted, was also a part-owner of Danflor Development and on the board of directors of the Homeowners Association, oversaw construction of the house on behalf of Danflor Development. Aughenbaugh moved into the house in May of 2004 and thereupon, began conducting her personal training business in the gym area of the house. However, a short time later she received a letter dated June 21, 2004, and signed by Atchley on behalf of the board of directors for the Homeowners Association that provided in pertinent part as follows:

Please find enclosed a copy of the Restrictive Covenants for Island Brook Subdivision, specifically page 222 of the Island Brook Restrictions. Item 30 and 32 states that:

“... Use of Premises: Each Lot shall be used only for private, single family residential purposes.”

¹ The declaration of restrictions was registered with the Sumner County register of deeds on January 25, 2002.

“... No house or structure on any Lot may be used for any business or commercial purpose. Each owner and occupant shall refrain from any conduct that could ... disturb the peace and quiet of the adjoining and surrounding Lots and or Owners.”

You are currently in violation of the covenant.

This letter will serve as formal notice that you have TEN DAYS (10) from receipt of this letter to cease and desist violation of item 30 and 32 of the Restrictive Covenants of the Island Brook Subdivision. Failure to do so will result in further action, as prescribed in the bylaws, by this body, and notification of the appropriate local, state and federal authorities.

Contrary to the demands of this letter, Aughenbaugh continued to conduct her personal training business out of her home and on October 15, 2004, the Homeowners Association filed a complaint requesting that the trial court permanently enjoin her from doing so. In response, Aughenbaugh filed an answer and countercomplaint, asserting *inter alia* that by prior actions, the Homeowners Association had waived the restrictive covenants at issue. Aughenbaugh's response also included a third party complaint against Danflor Development and Atchley, Wilkinson, and Carlyle, individually, that included the following allegations:

... Wilkinson, Atchley, Carlyle and Danflor built the home for Aughenbaugh; modified the home to allow the home gym; were fully aware of its use and intended use; provided assurance to Aughenbaugh so that she could use the property as she intended; induced her to construct the home on said promise; actually trained with her; and encouraged others to train there as well.
* * *

In the alternative, if enforcement of the covenants is allowed and Aughenbaugh is not able to use her property for her personal fitness training activities, then Third Party Defendants falsely misrepresented to Aughenbaugh her use and ability to use her property and induced her to enter into the purchase and construction of the home with no intent to allow the use as promised.

The original complaint and countercomplaint were consolidated with the third party complaint, and the case was tried before a jury in July of 2006. At the close of proof, the trial court granted the Homeowners Association's motion for directed verdict, permanently enjoined Aughenbaugh from using her home "to operate a business or for any other commercial purpose, including but not limited to her personal training business," dismissed all claims in Aughenbaugh's countercomplaint, and awarded the Association attorney's fees and discretionary costs in the amount of \$31,158.20. The trial court also granted a motion for directed verdict filed by the third party defendants, Carlyle, Atchley, and Wilkinson, ruling that Aughenbaugh had presented insufficient evidence to allow her claims against these defendants to be presented to the jury. Finally, the trial court denied a motion for directed verdict filed by Danflor

Development, and the jury found Danflor Development liable to Aughenbaugh for misrepresentation and set damages in the amount of \$75,000, apportioned between the parties based upon fault, with 30% (\$22,500) being charged to Aughenbaugh and 70% (\$52,500) to Danflor Development. Thereafter, Aughenbaugh filed a motion requesting that the trial court alter or amend its directed verdict dismissing her countercomplaint against Atchley and Wilkinson; however, this motion was denied. A motion by Danflor Development to set aside the jury's verdict against it was also denied. Subsequently, Aughenbaugh filed the appeal now before us.

II. Issues

The following issues are presented for our review:

- 1) Whether the trial court erred in granting a directed verdict in favor of the Homeowners Association permanently enjoining Aughenbaugh from conducting her personal training business out of her home and in allowing the Homeowners Association a judgment for attorney's fees.
- 2) Whether the trial court erred in granting a directed verdict in favor of Atchley and Wilkinson², dismissing Aughenbaugh's third party complaint against them as individual defendants.
- 3) Whether the trial court erred in failing to dismiss Aughenbaugh's claim against Danflor Development upon its motion for directed verdict.

III. Analysis

A. Directed Verdict Permanently Enjoining Business and Attorney's Fees

The first issue we address is whether the trial court erred in granting the Homeowners Association's motion for a directed verdict permanently enjoining Aughenbaugh from using her home for business purposes. Aughenbaugh contends that she submitted sufficient evidence from which the jury could have concluded that the Homeowners Association impliedly waived the restrictive covenants that prohibited her from using her house for business purposes or was equitably estopped from enforcing same. We do not agree.

We recently restated the standard governing our review of a directed verdict as follows:

We review a trial court's decision on a motion for directed verdict *de novo*, "applying the same standards as the trial court." *Biscan v. Brown*, 160 S.W.3d 462, 470 (Tenn. 2005) (citing *Gaston v. Tenn. Farmers Mut. Ins. Co.*, 120 S.W.3d 815, 819 (Tenn.

² Although, as we have indicated, Carlyle was named as a third party defendant in Aughenbaugh's countercomplaint, Aughenbaugh's motion to alter or amend requested that the trial court reconsider its dismissal of such complaint with respect to Atchley and Wilkinson alone. Further, in the argument portion of her brief, Aughenbaugh asserts that there was sufficient evidence presented to show that the case should not have been dismissed as to Atchley and Wilkinson, and she makes no such assertion with respect to Carlyle. Accordingly, we deem that Aughenbaugh's appeal does not extend to the trial court's ruling with respect to the liability of Carlyle and therefore, we do not find that he is a party to this appeal.

2003)). A directed verdict is appropriate “only when the evidence in the case is susceptible to but one conclusion.” *Childress v. Currie*, 74 S.W.3d 324, 328 (Tenn. 2002) (citing *Eaton v. McClain*, 891 S.W.2d 587, 590 (Tenn. 1994)). We must “take the strongest legitimate view of the evidence favoring the opponent of the motion,” allowing “all reasonable inferences in favor of the opponent of the motion,” and disregarding “all evidence contrary to the opponents’s position.” *Id.* After assessing the evidence in this fashion, we will affirm the directed verdict only upon a determination “that reasonable minds could not differ as to the conclusions to be drawn from the evidence.” *Eaton*, 891 S.W.2d at 590.

Helton v. Glenn Enterprises, Inc. 209 S.W.3d 619, 624 (Tenn. Ct. App. 2006).

The essential elements of the defenses of implied waiver and equitable estoppel are one and the same, *Chattem, Inc. v. Provident Life & Accident Ins. Co.*, 676 S.W.2d 953, 955 (Tenn. 1984), and have been stated by the Tennessee Supreme Court as follows:

The essential elements of an equitable estoppel as related to the party estopped are said to be (1) Conduct which amounts to a false representation or concealment of material facts, or, at least, which is calculated to convey the impression that the facts are otherwise than, and inconsistent with, those which the party subsequently attempts to assert; (2) Intention, or at least expectation that such conduct shall be acted upon by the other party; (3) Knowledge, actual or constructive, of the real facts. As related to the party claiming the estoppel they are: (1) Lack of knowledge and of the means of knowledge of the truth as to the facts in question; (2) *Reliance upon the conduct of the party estopped*; and (3) Action based thereon of such a character as to change his position prejudicially.

Callahan v. Town of Middleton, 292 S.W.2d 501, 508 (Tenn. 1954) (emphasis added).

In support of her argument that the trial court erred in directing a verdict in favor of the Homeowners Association, Aughenbaugh contends that proof was submitted from which a jury could have reasonably concluded that Atchley and Wilkinson were the alter egos of the Association, and that they were aware of and encouraged her intention to use her house for business purposes. Aughenbaugh asserts that, as the Association’s alter ego, the knowledge and actions of Atchley and Wilkinson were imputed to the Association, and that by their conduct, Atchley and Wilkinson, on behalf of the Association, waived the restrictive covenants. Aughenbaugh relies on testimony showing that Atchley and Wilkinson were aware that she was building a gym in her home and planned to continue her personal training business from the new home.

While Aughenbaugh presented evidence of certain actions of Atchley and Wilkinson that were not consistent with the restrictive covenants as they related to her house, she did not submit

any proof that she relied on the conduct of the Homeowners Association or anyone acting on its behalf when she concluded that she could operate her business out of her home. She submitted no evidence that she knew or had reason to believe that Atchley and Wilkinson were acting on behalf of the Homeowners Association, that they controlled the Homeowner Association's board of directors, or were even on the board, until she received the letter of June 21, 1004, demanding that she cease violating the restrictive covenants. By that point in time, her house was complete. Aughenbaugh concedes that she received a copy of the declaration of restrictions at closing, and absent proof that she knew or had reason to believe that Atchley and Wilkinson controlled the board/Association, it cannot be inferred that she relied upon their actions as a waiver of any restrictive covenants by the Association. While both the declaration of restrictions and bylaws showed that Atchley and Wilkinson were on the board and Aughenbaugh was provided with a copy of each these documents, Aughenbaugh attested that she did not read either document until she received the letter of June 21, 2004. Aughenbaugh further testified that until she received such letter, she did not inquire as to who was on the Association's board of directors:

Q You received a letter regarding the operation of a business in your home?

A Uh-huh.

Q Prior to that time had you - - from the time you bought the property until then had you asked about the constitution of the board or who was on the board?

A No.

Because Aughenbaugh failed to present any evidence that before June of 2004, she knew Atchley and Wilkinson to be in control of the Homeowners Association, she could not have relied upon their conduct as a waiver by the Association. Therefore, we do not find that the trial court erred in granting the Association a directed verdict.

Aughenbaugh also takes issue with the trial court's grant of attorney's fees to the Homeowners Association. Aughenbaugh's argument that the attorney fees should not have been awarded is premised upon her contention that the trial court erred in granting its motion for directed verdict. In light of our above-stated decision in that regard, this issue is without merit.

B. Dismissal of Third Party Complaint Against Atchley and Wilkinson

The next issue presented is whether the trial court erred in dismissing Aughenbaugh's third party complaint against Atchley and Wilkinson. In this regard, Aughenbaugh argues that she presented adequate evidence from which a jury could have reasonably concluded that Atchley and Wilkinson were alter egos of the Homeowners Association and Danflor Development and, consequently, are also liable for any judgments against the latter two entities.

Because we have already determined that the trial court properly granted the directed verdict dismissing Aughenbaugh's countercomplaint against the Homeowners Association, no issue remains as to what, if any, liability Atchley and Wilkinson might share with the Association.

However, Aughenbaugh also contends that Atchley and Wilkinson "should have been kept in the lawsuit for the jury to consider if they were personally liable for the misrepresentation found against Danflor" and that "the individual defendants should be reinstated and the verdict for misrepresentation extended to them, since there [sic] were the true entities behind Danflor Development, and the ones who actually committed the misrepresentation." Upon a finding that Atchley and Wilkinson were, in fact, the alter egos of Danflor Development, it necessarily follows that any judgment against Danflor Development would constitute a judgment against Atchley and Wilkinson, there then being no legal distinction among the three. See *The Oceanics Schools, Inc. v. Barbour*, 112 S.W.3d 135, 145-46 (Tenn. Ct. App. 2003).

In addressing the question of whether a corporation's controlling shareholders/owners such as Atchley and Wilkinson should be held liable for an obligation of the corporation, we are guided by the following restatement of relevant Tennessee law as set forth in *The Oceanics Schools*:

A corporation is presumptively treated as a distinct entity, separate from its shareholders, officers, and directors. A corporation's separate identity may be disregarded or pierced, however, upon a showing that it is a sham or a dummy or where necessary to accomplish justice. A corporation's identity should be disregarded with great caution and not precipitately. The determination of whether to disregard the corporate fiction depends on the special circumstances of each case, and the matter is particularly within the province of the trial court. Generally, no one factor is conclusive in determining whether or not to disregard a corporate entity; rather, the courts typically rely upon a combination of factors in deciding such an issue. The party wishing to pierce the corporate veil has the burden of presenting facts demonstrating that it is entitled to this equitable relief.

Id. at 140 (citations, internal emphasis, and internal quotation marks omitted).

In *Continental Bankers Life Ins. Co. of the South v. The Bank of Alamo*, 578 S.W.2d 625, 632 (Tenn. 1979), the Tennessee Supreme Court set forth three elements required to pierce the corporate veil as between a parent corporation and its subsidiary:

- 1) The parent corporation, at the time of the transaction complained of, exercises complete dominion over its subsidiary, not only of finances, but of policy and business practice in respect to the transaction under attack, so that the corporate entity, as to that transaction, had no separate mind, will or existence of its own.
- 2) Such control must have been used to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of third parties' rights.
- 3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.

In our subsequent decision in *Tennessee Racquetball Investors, Ltd. v. Bell*, 709 S.W.2d 617, 622 (Tenn. Ct. App. 1986), we recognized that these elements are also required in an action to hold the individual owner of a corporation liable for the debts of the corporation under the alter ego theory. We believe that there is proof in the record from which a jury could reasonably conclude that the elements required to pierce the corporate veil have been established.

The first element requires a showing that the individual exercised dominion and control over the corporation. Atchley testified that she, Wilkinson, and Carlyle own Danflor Development, and that they were the sole members, shareholders, and participants in regard to that entity. Wilkinson testified that Atchley “runs the business end” of Danflor Development and he “[does] the work on job sites and build[s] the houses.” No evidence was presented that any other individuals conducted business on behalf of Danflor Development. Aughenbaugh testified that she worked with Atchley and Wilkinson personally in constructing the house and that they approved of everything she did in that regard.

The second element requires proof that the “control must have been used to commit fraud or wrong, to perpetuate the violation of a statutory or other positive legal duty, or dishonest and unjust act in contravention of third parties' rights.” There was testimony at trial that Atchley and Wilkinson were aware of the restrictive covenants and, in fact, Atchley testified that she herself drafted the declaration of restrictions on behalf of Danflor Development. Further, there was proof from which it could be inferred that, despite being aware of the restrictions and that they had not been waived, Atchley and Wilkinson encouraged Aughenbaugh's continued construction of the house in a manner consistent with her intention to operate her business therefrom and led her to believe that there would be no restrictions to prevent her from acting upon such intentions. In that regard, testimony was presented showing the following: that Wilkinson assisted Aughenbaugh in designing the house so that she could have her gym there; that Atchley knew that Aughenbaugh was planning to operate the business out of her house and was present when Aughenbaugh and her clients discussed floor tiles and carpeting for the gym; that Wilkinson discussed the location of the gym with Aughenbaugh prior to construction and agreed to reinforce the gym floor to support weight equipment; that Atchley indicated that a parking pad would have to be constructed so that Aughenbaugh's clients would not have to park their cars on the street; that Wilkinson installed a walkway around the side of her house so that Aughenbaugh's clients would not have to walk on the grass; that Atchley actually worked out with Aughenbaugh in her garage in her previous home and admitted that as of March 2004, while the new home was under construction, she became aware that the personal training service

conducted by Aughenbaugh was a business for profit and that she knew that Aughenbaugh planned to continue running such business out of her new home; and that neither Atchley nor Wilkinson advised Aughenbaugh that she would not be allowed to operate her business out of her new home and that Aughenbaugh was unaware that she would be prohibited from doing so until she received the June 21, 2004, letter from the Homeowners Association signed by Atchley.

The third element requires proof that the control and breach of duty must proximately cause the injury or unjust loss. There was evidence from which it could reasonably be inferred that as a result of the misleading conduct of Atchley and Wilkinson, Aughenbaugh paid to have a house constructed by Danflor Development that included an 1100-square-foot gym which she was unable to use for her business because of the restrictive covenants.

As we have indicated on prior occasion, “a determination of whether or not a corporation is a mere instrumentality of an individual is ordinarily a question of fact for the jury.” *Elec. Power Bd. of Chattanooga v. St. Joseph Valley Structural Steel Corp.*, 691 S.W.2d 522, 527 (Tenn. 1985). After careful review of the record, we see no reason why this general rule should not apply in the instant matter and accordingly, we hold that the trial court erred in dismissing Aughenbaugh’s complaint against Atchley and Wilkinson upon their motion for directed verdict.

C. Denial of Danflor Development’s Motion for Directed Verdict

The final issue we address is whether the trial court erred in denying Danflor Development’s motion for directed verdict on the issue of its liability for misrepresentation. Danflor Development cites *Killion v. Huddleston*, No. M2000-02413-COA-R3-CV, 2001 WL 1090505, (Tenn. Ct. App. M.S., filed Sept. 19, 2001) wherein we noted the following four elements required under Section 552 of the Restatement (Second) of Torts to establish a case for negligent misrepresentation:

- (1) The defendant must be acting in the course of his or her business or profession, or in a transaction in which he or she has a pecuniary interest;
- (2) The defendant must supply false information to the plaintiff and must intend that this information guide the [plaintiff] in a business transaction;
- (3) The defendant must fail to exercise reasonable care in obtaining or communicating the information; and
- (4) The plaintiff’s reliance upon the information must be justifiable.

Id. at *2.

Danflor Development asserts that the record shows, among other things, that Aughenbaugh knew that Island Brook Subdivision was highly restricted, that she was given copies of the declaration of restrictive covenants stating that she was prohibited from operating a business out of her home, and that her warranty deed referenced the restrictive covenants.

Therefore, Danflor Development argues that Aughenbaugh failed to prove that her reliance was justified because the content of the restrictive covenants was readily available to her and she chose not to avail herself of this knowledge to her detriment.

The trial court found that there was sufficient evidence from which a jury could infer that Aughenbaugh's reliance was justified. We conclude that this was a proper ruling. Whether or not Aughenbaugh was justified in her reliance upon such conduct was a question of fact properly addressed by the jury. *See* AM. JUR. 2D *Fraud and Deceit* § 502 (2001) ("Particular issues that are considered questions of fact include the existence of ... reasonable or justifiable reliance.") Moreover, the salient question in this case was not whether the activity engaged in by Aughenbaugh was an activity prohibited by the declaration of restrictions, but whether Danflor Development, through the conduct of its owners/members, indicated that such activity would be allowed despite any restrictions that might otherwise apply. We believe Aughenbaugh's previously referenced testimony regarding the actions of Atchley and Wilkinson during construction constituted evidence from which a jury could reasonably conclude that Aughenbaugh justifiably relied upon such conduct in her determination that she would not be prohibited from operating her business from her new home. Accordingly, we find no merit in Danflor Development's argument that the trial court erred in failing to grant its motion for directed verdict.

IV. Conclusion

For the reasons stated herein, the judgment of the trial court is affirmed in part and reversed in part, and this cause is remanded for further action consistent with our decision herein. Costs of appeal are assessed to Janice Aughenbaugh, Lori Atchley, Frank Wilkinson, and Danflor Development, LLC, equally.

SHARON G. LEE, JUDGE