

ATTORNEYS AT LAW

RICHARD T. SIMMONS, JR.*
DOMINIC J. OVELLA ‡ †
C. KELLY LIGHTFOOT
W. EVAN PLAUCHÉ †
MICHAEL J. VONDENSTEIN
DAVID K. PERSONS
JOHN E. UNSWORTH, JR.
CAROLINE D. IBOS
JOSEPH L. SPILMAN, III ¶ VAV
KEVIN O. LARMANN
DARREN A. PATIN
ANNE E. MEDO ‡
SEAN P. MOUNT ‡ †
W. GLENN BURNS
GABRIEL J. VENINATA
JUSTIN E. ALSTERBERG

RICHARD B. TUBERTINI °
BARBARA B. O'DONNELL
JANET M. TOWNSLEY ‡

OF COUNSEL
JAMES W. HAILEY, JR. (RETIRED)
HENRY D. MCNAMARA, JR. (1934-2011)
W. MARVIN HALL*
ANTONIO E. PAPALE, JR.*
LAURENCE E. LARMANN*
CLAUDE A. GRECO

COURTHOUSE STATION
302 COURTHOUSE ROAD
SUITE A
GULFPORT, MS 39507

TELEPHONE: (228) 896-1144
TELECOPIER: (228) 896-1177

OFFICES ALSO IN:

NEW ORLEANS, LOUISIANA
METAIRIE, LOUISIANA
BATON ROUGE, LOUISIANA
HOUSTON, TEXAS

www.haileymcnamara.com

JOHN.GUTIERREZ@HMHLP.COM

February 21, 2013

ALAYNE R. CORCORAN
JAMES D. GARVEY, JR.
JOHN C. DUPLANTIER
RALPH T. RABALAIS
H. JOHN GUTIERREZ † ‡
STEPHEN A. ANDERSON °

WILLIAM R. SEAY, JR.
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LAUREN E. BRISBI
JUSTIN E. ALSTERBERG
JASON M. BAER
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CHRISTOPHER M. G'SELL
EVAN J. BERGERON
CHRISTOPHER G. OTTEN
RICHARD J. GARVEY, JR.
PHILIP D. LORIO, IV
MATTHEW D. MOGHIS

*PROFESSIONAL CORP.
ALSO ADMITTED IN:
V ALABAMA
Δ CALIFORNIA
◊ IOWA
∇ MARYLAND
† MISSISSIPPI
° ONLY IN MISSISSIPPI
‡ TEXAS
‡ ONLY IN TEXAS
Λ WASHINGTON, D.C.

Marshall Kyger
Diamondhead Country Club and
Property Owners Association, Inc.
5300 Diamondhead Circle
Diamondhead, MS 39525

Re: **Planning for 2020: Master Covenants and Takeover Agreement**

Dear Marshall:

In this letter, we provide an overall assessment of the issues relating to the potential expiration of the Master Covenants and Takeover Agreement in 2020 and lay out options for how the POA can best deal with those issues.

Expiration Dates and the Issues at Stake:

The Master Covenants and the Takeover Agreement each include an expiration date in June 2020. The Master Covenants, created in 1970, include a fifty-year term, which expires June 17, 2020. The Takeover Agreement dated 1984, by which the POA agreed to take over the common amenities, states that its terms expire on June 16, 2020, or upon expiration of the Diamondhead Master Covenants, whichever occurs first.

Expiration of the Master Covenants would affect the POA's right to assess and its right to architectural control. Purcell originally had architectural control under the Master Covenants. In 1989, Purcell transferred the right of architectural control to the POA. Purcell and the POA both have the right to assess under the Master Covenants. In the Takeover Agreement, Purcell assigned its right to assess to the POA; therefore, since 1984, only the POA has had the right to

assess. The Takeover Agreement also requires the POA to maintain the common facilities to the same standard Purcell always maintained them.

Thus, if both the Master Covenants and Takeover Agreement expire, the POA will no longer have architectural control over the residential lots, will no longer have the right to assess, and will no longer be bound to maintain the amenities to a certain standard. Losing the right to assess would surely lead to the closing of amenities that are not self-sustaining, i.e., that cost more money than they bring in.

Extending the Master Covenants:

In early 2010, the POA Board retained us to work on a strategy for preventing the expiration of the Master Covenants in 2020. In August 2009, the Board had received an opinion from the law firm Newton & Hoff that the POA could amend the Master Covenants to remove their expiration date by incorporating the Master Covenants into the Bylaws. Newton & Hoff's opinion was that such action was authorized by the Mississippi Supreme Court's opinion in *Perry v. Bridgetown Community Assn., Inc.* We conducted an independent review of the relevant law and provided the POA with an opinion letter dated March 8, 2010. That letter sets forth the details of our legal analysis, but in summary, we agreed with Newton & Hoff that the *Perry* opinion allowed the POA to amend its bylaws to incorporate the Master Covenants without an expiration date.

In a follow-up letter dated March 11, 2010, we acknowledged that the *Perry* opinion "is subject to contrary interpretations" and that there was "some degree of risk" that incorporation of the covenants into the bylaws might be subject to challenge. Nevertheless, the Board decided that it was the best option. Before reaching that conclusion, the Board first rejected two other options.

First, the Board decided that it would be impossible to get the number of votes required—85% of members—to amend the Master Covenants. Second, the Board decided it would be too risky to seek judicial amendment. That option requires filing a petition in Chancery Court asking a judge to reform the Master Covenants by removing either the expiration provision or the requirement of an 85% vote to amend. We advised that seeking judicial amendment exposes the POA to the possibility of protracted litigation if the petition is opposed and that it also presents a risk that the petition might be denied. The standards for judicial reformation of restrictive covenants are not well-established in Mississippi, so it is difficult to predict what a court would do when presented with such a petition.

In June 2010, the members voted to incorporate the covenants into the Bylaws—omitting their expiration date in the process—and on October 15, 2010, we filed notification in the land records. We advised the Board that any challenge to the incorporation of the covenants into the Bylaws would be subject to a three-year statute of limitations, which would require any

challenge to be brought prior to October 15, 2013. For your reference, we enclose copies of our opinion letters dated March 8, 2010, March 11, 2010, and November 8, 2010.

After October 15, 2013, the risk that the incorporation of the covenants into the Bylaws could be successfully challenged decreases but does not go away entirely. Chancery Courts, being courts of equity, have a great deal of discretion in matters relating to real property. It is possible that a Chancery Court could review the incorporation of the covenants into the Bylaws and find it invalid. We think there is a low risk of that outcome, but it is possible. It also is possible that a court might decide that a resident will not have standing to bring an action challenging the amended Bylaws until the POA actually asserts its right to assess or to architectural control after June 2020. Again, we think the better analysis is that a resident has standing now, and therefore should bring any challenge prior to October 15, 2013, but it is possible that a judge might see it differently.

In 2010, the Board was willing to accept the degree of uncertainty that came with incorporating the covenants into the Bylaws. If the current Board would like additional certainty in regard to the expiration of the Master Covenants, two options remain: (1) amend the Master Covenants by obtaining a vote of 85% of the members, or (2) obtain a court order reforming the Master Covenants either by removing the expiration provision or lowering the number of member votes required for amendment to an amount that can be obtained.

The latter option, as discussed above, presents risks that are difficult to assess. If the POA decides to move forward with judicial action, one strategy to consider is to ask the Court to affirm the incorporation of the covenants into the Bylaws already done under *Perry*. This could be done as an alternative argument to seeking reformation of the Master Covenants. We would need to conduct some additional research in order to flesh out a complete strategy for bringing an action in Chancery Court.

Renewing the Takeover Agreement (aka Supplemental Agreement):

Renewing the Takeover Agreement is another necessary step. Without its renewal, the POA will have no continuing obligation to maintain the amenities to a certain standard. Renewal of the Takeover Agreement can be accomplished by an amendment to the Supplemental Agreement between the POA and Purcell dated December 13, 1984. Enclosed is a draft of an amendment to the Supplemental Agreement to address various issues we identified.

The draft addresses the expiration of the Supplemental Agreement by instead providing for its automatic renewal every twenty years. In addition, the draft includes amendments needed in light of the dedication of the streets to the City, since they were part of the Common Facilities as defined in the Supplemental Agreement, and also to acknowledge the fact that the City's police and fire departments will, to some extent, replace services provided by the POA. In making these changes, we have been careful to not do anything to affect or ignore the parties'

Marshall Kyger
February 21, 2013
Page 4

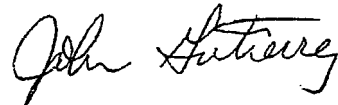
observation of the terms of the Supplemental Agreement between 1985 and 2013. Rather, our amendments only make changes to ratify recent occurrences and plan for the future.

There is one issue relating to the Takeover Agreement where we need additional information from you. At the April 2012 meeting, there was some discussion that the POA might wish to make changes to the provisions in paragraph 12 relating to "renters", but our notes are not clear. Can you remind us what changes, if any, you would like in that regard?

Let us know if you have any further questions. Rick will be getting in touch with you soon to schedule a meeting with the officers to review these issues.

Best regards,

HAILEY, MCNAMARA, HALL,
LARMANN & PAPALE, LLP

A handwritten signature in black ink, appearing to read "John Gutierrez". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

John Gutierrez

HJG;jhs
Enclosure