IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

SWANN KEYS CIVIC ASSOCIATION, Plaintiff, v. BARBARA B. SHAMP, JOHN E. HUMPHREYS and JUDITH A. HUMPHREYS, Defendants.	)	C.A. No. 3368-VCS

MEMORANDUM OPINION

Date Submitted: August 21, 2008
Date Decided: September 29, 2008

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STRINE, Vice Chancellor.

I. Introduction

This is the post-trial decision in an action concerning a restrictive covenant that purports to limit the height of homes in Swann Keys, a waterfront community of 603 lots located in Sussex County, Delaware. The plaintiff is the Swann Keys Civic Association (the "Association"), a non-stock, nonprofit corporation of which all lot owners in Swann Keys are members. The covenant at issue is part of the "Swann Keys Rules and Regulations" (the "Rules and Regulations") adopted and recorded by the Association in 1995 following a majority vote of approval by the Swann Keys lot owners. The defendants are Barbara B. Shamp and John E. and Judith A. Humphreys, members of the Association who purchased their lots in Swann Keys after 1995. Shamp and the Humphreys have recently built two-story homes on their respective lots in violation of the 16'6" height restriction found in the Rules and Regulations (the "Height Restriction"), having begun their plans before this case was initiated and having completed or nearly completed construction while this case was in litigation. The Association brought this action for a permanent injunction requiring the defendants to remove or tear down their newly constructed homes to bring them in compliance with the Height Restriction.

The defendants contend that the Height Restriction is unenforceable because the Association did not have the power to adopt a restrictive covenant limiting a homeowner's use of her own property.

In this opinion, I accept the defendants' contention and deny the Association's request for a permanent injunction. This case turns on an order and final judgment issued

by this court in 1984 (the "Chancery Final Judgment") which formed the Association and granted it the authority to adopt "reasonable rules and regulations for the operation of Swann Keys."[1] The Chancery Final Judgment was the result of class action litigation seeking to enforce a covenant found in the deeds of some Swann Keys lot owners requiring the developers to form a nonprofit corporation of which all lot owners would be members and which would collect assessments and operate the common areas of Swann Keys. The Association reads the language of the Chancery Final Judgment broadly to authorize the adoption of restrictions that affect individual lot owners' use of their own parcels. But, this interpretation is at odds with the narrow purpose for which the class was certified in the prior litigation, which was to resolve matters related to common area maintenance. Thus, I find that the Association's power to adopt rules and regulations under the Chancery Final Judgment is limited to matters involving the governance of the Association as an organization itself and the maintenance of the common areas and amenities of Swann Keys. That is the intended scope of the Association's regulatory power to "operate" Swann Keys. Because the Height Restriction does not address these issues, but only limits how specific parcel owners may use their property, the Height Restriction is unenforceable.

II. Factual Background

The parties agreed to waive their right to a trial with live witness testimony and to have the court decide the case on the basis of a stipulated set of facts and certain undisputed exhibits the parties have submitted. Thus, this opinion is in the nature of a

[1] JX 8.

post-trial opinion that is based — at the parties' joint request — on the paper "trial" record they have submitted. These are the facts as I find them from the trial record.

A. The Development Of Swann Keys

Swann Keys was developed in the 1960s and 1970s as a waterfront mobile home park. The site was managed by three successive developers: first James and Gladys Swann, then Exten Associates ("Exten"), and finally B.E.T., Inc. ("BET"). The Swanns provided for the operation and maintenance of the common areas of the community through Restriction No. 12, which was part of a list of "Restrictions running with the land" attached to certain deeds conveyed by the Swanns.[2] Restriction No. 12 states: "Each property owner agrees to pay his pro-rata share upon assessment by a non-profit corporation or other association of lot owners which shall operate the utilities and maintain the streets and pool, park, [and] common areas of the development."[3]

The majority of the deeds conveyed by the Swanns contained Restriction No. 12, including the deeds transferred to Exten. But, Exten and BET were inconsistent in their use of Restriction No. 12 in the deeds they conveyed to individual lot owners. Some deeds omitted Restriction No. 12 completely, while others contained a variation that required assessment but did not mention an association of lot owners. To further complicate matters, some lots were obtained through deeds from the Swanns that did not have the "Restrictions running with the land" physically attached, and other lots were obtained through a sheriff's sale after Exten declared bankruptcy.

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[2] JX 19.
[3] *Id.*

B. The 1980s Litigation

In the midst of this confusion in the deeds, and prompted by BET's failure to provide adequate maintenance of the common areas and amenities, several homeowners brought suit in this court to enforce Restriction No. 12. The complaint, filed in 1980, alleged that BET refused to form a nonprofit corporation as required by Restriction No. 12. The plaintiffs requested that the court "determine the rights of the parties, particularly with respect to whether [BET] is required to form a non-profit corporation pursuant to Restriction No. 12" or, in the alternative, "issue an injunction requiring [BET] to form a non-profit corporation pursuant to Restriction No. 12 to operate utilities and maintain the streets, pool, park, and common areas of the development."[4]

This court, through then-Vice Chancellor Hartnett, concluded during pretrial proceedings that "no decree could be entered which would be binding on the owners of all the lots in the subdivision" unless all the lot owners were made parties through joinder or certification of a class action.[5] The plaintiffs therefore sent a Class Action Notice of Hearing ("the Notice") to all homeowners in Swann Keys advising them that "[i]f the plaintiffs obtain the relief they seek under the Complaint, it could result in a nonprofit corporation being formed to operate the utilities and maintain the streets, pool, park, and common areas."[6]

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[4] JX 1.
[5] JX 5 at 2.
[6] JX 4 ¶ 9.

This court ultimately certified a class that included all lot owners in Swann Keys.[7] On a motion for summary judgment, Vice Chancellor Hartnett concluded that all lots in Swann Keys were subject to Restriction No. 12 and that BET was required to transfer title to the common areas to a nonprofit corporation that was to be formed. The Vice Chancellor then instructed the parties to determine "how the nonprofit corporation is to obtain title to the common facilities and the amount of any sum to be paid to defendants as reimbursement for some or all of the costs of the common facilities . . . ."[8]

In a "Settlement Agreement" dated September 10, 1985, the parties agreed that BET would convey all the common areas and amenities of Swann Keys to the Association. The parties also attempted to create a new list of restrictive covenants by conditioning the Agreement on "the execution and entry of a court judgment incorporating this Compromise and Settlement Agreement in the decree and further binding all the property owners of Swann Keys to a set of restrictions subject to the approval of the Court."[9] The subject matter of those yet-to-be-drafted restrictions was described as follows:

> *Without limitation on the scope of the restrictions*, the Swann [K]eys Civic Association will be designated as the nonprofit corporation comprised of all lot owners of Swann [K]eys to operate the common areas and amenities and will have the power to assess all the Swann Keys lot owners for the operation and maintenance of the common areas who will be members of the Association. The restrictions will provide for a special assessment or

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[7] JX 5 at 8. Despite the equitable nature of the suit, Swann Keys lot owners were given the opportunity to opt out of the class. Only one couple did so, electing to pursue an already pending action, but there is no contention that their lot is one of the ones at issue now.
[8] *Atkinson v. B.E.T., Inc.*, 1984 WL 159375, at *5 (Del. Ch. Dec. 4, 1984).
[9] JX 9.

> assessments to raise money for repayment of the loan used for the funding of this purchase . . . .[10]

The finalized list of restrictions was to be submitted to the court three weeks after the execution of the Settlement Agreement. The Settlement Agreement made no other provision for the homeowner assessments that would be necessary to fund the initial transfer of the common areas and to sustain the Association.

But, Vice Chancellor Hartnett rejected the idea of putting in place, by judicial order, a new, separate set of restrictive covenants that could have no "limitation on the[ir] scope."[11] Instead, the Vice Chancellor did something narrower and more tailored to the core issues of the lawsuit. The Final Judgment entered by Vice Chancellor Hartnett provided that every property owner of Swann Keys: (i) will be a member of the Swann Keys Civic Association, a nonprofit, nonstock corporation; (ii) will have the right to elect members to the Board of the Association; and (iii) will be assessed for past due fees, special fees necessary to effectuate the conveyance of the common areas, and maintenance fees in the future. In the middle of this discussion, the Chancery Final Judgment states that:

> The Board of Directors may recommend reasonable rules and regulations for the *operation of Swann Keys* subject to approval by a majority of the lot owners. Upon approval by the majority of the lot owners, the rules and regulations shall bind and be enforceable upon all the lot owners of Swann Keys, their heirs, executors, successors and assigns.[12]

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[10] *Id.* (emphasis added).
[11] *Id.*
[12] JX 8 ¶ 6 (emphasis added).

C. The 1995 Adoption Of The Rules And Regulations

In 1986, five months after the completion of the litigation described above, the Zoning Committee of the Association adopted a set of "zoning regulations" described as "restrictions running with the land, in Swann Keys, in accordance with the Zoning and Planning Commission of Sussex County"[13] (the "Swann Keys Zoning Regulations"). The Swann Keys Zoning Regulations primarily dictated minimum setbacks and maximum dimensions of improvements, including a requirement that "Roofs must not exceed Fifteen Feet (15') in height."[14] The record does not indicate what authority the Association relied on in adopting the Swann Key Zoning Regulations, and it is unclear how they were adopted, including whether or not there was a lot owner vote. Nevertheless, the property owners of Swann Keys appear to have complied with the Swann Keys Zoning Regulations with little objection.

The Association revisited the Swann Keys Zoning Regulations in the mid-1990s after action by the Sussex County Planning and Zoning Commission. At some point, the Planning and Zoning Commission rezoned Swann Keys from the classification of "mobile home park" to that of "general residence," and in late 1993 the Association was informed that the Swann Keys owners must comply with the new zoning. The immediate problem for Swann Keys involved a conflict between their setback requirements and the County's, but members of the Board also raised the issue of what to do with the 15' height limitation in the Swann Keys Zoning Regulations, which was much shorter than

[13] JX 80.
[14] *Id.* ¶ 3(D).

the 42' limit in Sussex County. After lengthy discussions of these matters, the Board adopted the Rules and Regulations, including the 16'6" Height Restriction. Then, in contrast to the prior procedure used in 1986, the Board put the Rules and Regulations to a vote by the Swann Keys lot owners, who approved all of the proposed rules by a majority.[15] The vote was apparently designed to ensure that it met the requirements under Paragraph 6 of the Chancery Final Judgment for adopting binding and enforceable "rules and regulations."[16] The ballot results were duly certified and the Rules and Regulations were recorded with the Sussex County Recorder of Deeds in February 1995.

The legitimacy and enforceability of the 1995 Rules and Regulations has been challenged periodically by the residents of Swann Keys during Association meetings, but this dispute is the first to bring the issue before a court.

D. The Construction That Exceeds The 16'6" Restriction

Defendants John and Judith Humphreys purchased their disputed lot in 1998,[17] and defendant Barbara Shamp purchased her lot in 2006. In late 2007, both Shamp and the Humphreys began construction of two-story homes on their respective lots that greatly exceed the 16'6" Height Restriction.[18] At that time, the Association sought a temporary restraining order against the construction. That action was denied with a

[15] The defendants attempt, some thirteen years later, to raise a question of whether a majority was actually achieved. I need not reach that question, given that I find for the defendants on other grounds.

[16] *See* JX 88; JX 43.

[17] The Humphreys purchased a second lot in Swann Keys in 2002, but that lot is not at issue in this case.

[18] There has been debate among the parties whether the Height Restriction is ambiguous in its definition of the height of a building. But, there has been no contention that the defendants' homes would be within the limitation under any possible reading of the Restriction.

warning to the defendants that they would be proceeding at their own risk pending the outcome of this litigation. At the time of trial, the Humphrey home was fully constructed and the Shamp home was well under way.

III. Legal Analysis

In the usual restrictive covenant case, the issue is whether a restrictive covenant in a deed an owner freely accepted is reasonable, clear, and sets forth a legitimate, non-invidious constraint on the use of property. [19] Here, the fundamental difference is foundational: does Paragraph 6 of the Chancery Final Judgment authorize a majority of the residents of Swann Keys to adopt a restrictive covenant that restricts lot owners' use of their specific parcels? The plaintiff Association says yes and argues that the words "recommend reasonable rules and regulations for the operation of Swann Keys subject to approval by a majority of the lot owners"[20] are capacious and permit a majority of residents in Swann Keys to adopt a restrictive covenant, such as the Height Restriction, that constrains the use of individual lots in Swann Keys. By contrast, the defendants say that the Association's authority to adopt rules and regulations is confined to those that involve the common areas and amenities of Swann Keys only.

After a careful review of the record, I find that the defendants have the better of the argument. In light of the court's narrow focus when it issued the Chancery Final Judgment, including the editing of the Settlement Agreement to exclude restrictive

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[19] *See, e.g., Plantation Park Ass'n v. Honaker*, 2005 WL 406436, at *1 (Del.Ch. Feb. 16, 2005); *Bethany Village Owners Ass'n. v. Fontana*, 1997 WL 695570, at *2 (Del Ch. Oct. 9, 1997); *Point Farm Homeowner's Ass'n, v. Evans*, 1993 WL 257404, at *2-3 (Del Ch. June 28, 1993).
[20] JX 8.

covenants not related to the assessments for the purchase and maintenance of the common areas, the Chancery Final Judgment cannot be read to authorize the Association to adopt, with a simple majority vote of the residents, restrictions that limit a property owner's use of her own land.

This action presents a unique situation. In general, a homeowner's deed, or a document incorporated by reference in the deed, is the source of any restrictive covenants on her property.[21] But, in Swann Keys the restrictive covenants contained in the residents' deeds failed to include key details concerning the governance of the community as a whole, such as a means for transferring title of the common areas to the Association and a mechanism for adopting or amending rules. These terms were instead supplied by this court's prior Final Judgment, and thus whatever authority the Association has to adopt new rules must arise from the Chancery Final Judgment.[22] The court's power, in turn, to bind all the lot owners to its Final Judgment came from the fact that all the lot owners were joined in that action through a class action certification. Therefore, the appropriate place to begin to understand the scope of the Chancery Final Judgment is the Notice of Class Action Hearing that preceded it.

The Notice advised lot owners in Swann Keys that the impending litigation "could result in a nonprofit corporation being formed to operate the utilities and maintain the

[21] *See* RESTATEMENT (THIRD) PROPERTY: SERVITUDES § 2.1 cmt. c (stating that in residential subdivisions, "[t]ypically, the servitudes are set out in a separate document . . . which is recorded and then incorporated by reference in the deeds to the individual parcels or units"); Note, *The Rule of Law in Residential Associations*, 99 HARV. L. REV. 472, 472 (1985) (noting that the sources of restrictions in a planned community are "covenants incorporated in the deeds to homes within a residential association").

[22] Indeed, the Association has not pointed to anything other than Paragraph 6 of the Chancery Final Judgment as the source of its authority to adopt the Height Restriction.

streets, pool, park, and common areas."[23] The Notice gave no indication that the rights of the lot owners in the free use of their individual parcels might be limited as a result of the litigation, much less that these rights could be altered at the whim of a future majority of the neighborhood's lot owners.[24]

The relatively narrow scope of the Notice makes sense in the context of the litigation. The facts alleged by the plaintiffs in their complaint pertained only to Restriction No. 12, which dealt with assessments for and maintenance of the common areas, and the relief they sought was resolution of the issues regarding maintenance of the common areas. In fact, once the court determined that Restriction No. 12 applied to all lot owners, it viewed the logistics of the conveyance of the common areas from BET to the Association as the only outstanding matter. In the court's view, there was no remaining issue in the case before it involving any other restrictive covenants.[25]

This reading is consistent with how the court altered the Settlement Agreement proposed by the parties. The Association slights the fact that the court removed the

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[23] JX 4 ¶ 9.

[24] The Association argues that this reasoning falls apart because the possibility of mandatory membership was not indicated in the Notice, which would mean that the Association's mandatory membership requirement is invalid. But, the fact that homeowners were on notice that such an association might be formed was enough to alert them that they may be required to participate under the "minimum procedural due process protection" standard. *Phillips Petroleum Co., v. Shutts*, 472 U.S. 797, 811-12 (1985). The only way the Association could function and perform its responsibilities is with the required financial support of all the lot owners. That was the obvious point of the lawsuit. And, if the Association believes this court's Notice regarding mandatory membership was constitutionally infirm, it is conceding that the residents of Swann Keys had no fair notice that the Association might, by judicial order, be given the right to regulate the use of specific parcels.

[25] *See Atkinson*, 1984 WL 159375, at *5 ("The only real issue to be determined in this lawsuit now revolves around a determination of how the nonprofit corporation is to obtain title to the common facilities . . . . It is time for the parties to stop wasting their time and money in arguing about other matters which will not contribute to the resolution of this matter.").

reference to a list of restrictions "without limitation on the[ir] scope" from the Settlement Agreement and instead wrote Paragraph 6 into the Final Judgment. Yet, I find it telling that Vice Chancellor Hartnett did not accede to the parties' request for authority to implement restrictive covenants of unlimited scope, and instead used the Final Judgment to implement the specific elements of the Settlement Agreement, namely the designation of an association to "assess all the Swann Keys lot owners" and "operate the common areas and amenities" of Swann Keys.[26] Because the lack of an amendment mechanism was one of the forces that led to the previous litigation, it is natural that Vice Chancellor Hartnett would include such a mechanism to give the Association the ongoing ability to adapt to new circumstances. But, there is no reason to think that this rulemaking power was meant to encompass matters outside the Association's responsibilities of lot owner assessment and common area maintenance.

The Association argues that the words "reasonable rules and regulations" in the Final Judgment replaced the "[restrictions] without limit" language from the Settlement Agreement without altering its breadth. This argument ignores the narrow focus of the court at the time of the settlement. The prior Chancery litigation was about the common areas of the community, and the task the parties were charged with at the settlement table was to develop a plan for the common areas of the community. In this light, it is reasonable to assume that Vice Chancellor Hartnett edited the Settlement Agreement in order to stay within the scope of the controversy, and, importantly, within the scope of matters for which the class was certified.

[26] JX 9.

Alternatively, the Association asserts that "rules and regulations" encompasses restrictive covenants like the one at issue here based on how that phrase is used elsewhere in the Chancery Final Judgment. In providing for certain exigencies in the transfer of title of the common areas, the court states that "[the new owners of certain lots] shall be members of the Swann Keys Civic Association and shall be subject to all applicable rules and regulation, including obligations to pay for the maintenance and other assessment fees on a prorata basis from the date of possession . . . ."[27] In other words, the Association argues that because Vice Chancellor Hartnett referred to the assessment requirement as a restrictive covenant throughout his opinion in the case,[28] we should read "obligations to pay . . ." in this passage as "restrictive covenants," which would mean "rules and regulations" includes all restrictive covenants.

There at least two problems with this reasoning. First, that interpretive argument addresses only half the ambiguity. Both "rules and regulations" and "for the operation of Swann Keys" are open for interpretation. Because "Swann Keys" is not qualified in the latter phrase, it could either mean the common areas of Swann Keys, or it could mean all of Swann Keys, including the individual lots. The narrow focus of the prior litigation suggests that the "operation of Swann Keys" refers to the orderly operation of the common areas. Indeed, "operation of Swann Keys" can easily be read as shorthand for the Settlement Agreement's phrasing: "the [Association] will . . . operate the common

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[27] JX 8 ¶ 6.

[28] *E.g., Atkinson*, 1984 WL 159375, at *1 ("[P]laintiffs . . . seek to have enforced a restrictive covenant which they assert requires the formation of a non-profit corporation to collect assessments and to operate the common areas of the park.").

areas and amenities."[29] Otherwise, the Association concedes, the Association could adopt, by a majority vote, a myriad of intrusive and constrictive restrictions potentially governing the ages of the residents in the development, the ability to own dogs or other pets, or the aesthetics of houses and lawns.[30] This reading is far too capacious given the narrow scope of the Class Action Notice.

Moreover, it is not clear that Vice Chancellor Hartnett's characterization of assessments for common area maintenance as restrictive covenants necessarily means we can simply swap out "assessment obligation" for "restrictive covenant" in the Chancery Final Judgment. The assessment obligation was at the core of the entire matter before the court — there would be no way to maintain the common areas of Swann Keys without an enforcement mechanism for the collection of assessments to fund the Association. Such a restrictive covenant, which pertains only to the common areas, is categorically different

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[29] JX 9.

[30] *See* Tr. at 8-10. I recognize that the scope of enforceable restrictive covenants is limited in some cases by statute or other law. For example, the Fair Housing Act, 42 U.S.C. § 3604, only allows age discrimination in developments that meet the criteria of "housing for older persons," 42 U.S.C. § 3607(b)(1). This court also requires that a restrictive covenant be reasonable and not against public policy to be enforceable. *E.g. Point Farm*, 1993 WL 257404, at *3; *see also* RESTATEMENT (THIRD) PROPERTY: SERVITUDES § 2.1 (stating the rule that a restrictive covenant is valid "unless it is illegal or unconstitutional or violates public policy"). Nevertheless, the types of restrictive covenants that have been upheld are wide-ranging and may regulate homeowner conduct "at a microlevel." Clayton P. Gillette, *Courts, Covenants and Communities*, 61 U. CHI. L. REV. 1375, 1384 (1994); *see, e.g., Villa De Las Palmas Homeowners Ass'n v. Terifaj*, 90 P.3d 1223 (Cal. 2004) (no-pet restriction); *Forest Glen Community Homeowners Ass'n v. Nolan*, 432 N.E.2d 636 (Ill. App. Ct. 1982) (prohibition against parking recreational vehicles on property); *Plantation Park Ass'n v. George*, 2007 WL 316391 (Del. Ch. Jan. 25, 2007) (requirement that dwellings in mobile home park be five years old or newer); *Dolan v. Villages of Clearwater Homeowner's Ass'n*, 2005 WL 2810724 (Del. Ch. Oct. 21, 2005) (requirement that homeowner maintain white pea gravel driveway, as well as other architectural features). The Association has essentially argued that it has the power to adopt restrictions to the full extent allowed by law, so each of these examples would be fair game for future restrictions in Swann Keys under the Association's view.

from a restrictive covenant that dictates how a property owner may use her own land. There is no indication that the Vice Chancellor intended that the Chancery Final Judgment would give the Association the capacious authority to, by a majority vote of the residents, adopt any restrictive covenant not prohibited by law. And, such an intent would be at odds with the scope of the litigation that was signaled in the Class Action Notice. Thus, a more reasonable reading of the passage cited by the Association is that members of the Association are bound to applicable rules and regulations or restrictive covenants that relate to "the operation and maintenance of the common areas [and amenities]" of Swann Keys.[31]

For the reasons described above, I conclude that the Association, even with the approval of a majority of the lot owners, does not have the power to restrict Swann Keys property owners in the free use of their individual lots. Therefore, the Height Restriction in the Rules and Regulations is unenforceable.

The defendants have raised alternative bases for denying enforcement, but because I find the issue of the Association's power under the Chancery Final Judgment dispositive, I will not address them here.

IV. Conclusion

For the foregoing reasons, the plaintiffs have not demonstrated that the height restriction is enforceable against the defendants. The request for permanent injunction is denied. The plaintiffs' complaint is dismissed. Each side shall bear its own costs.

[31] JX 9.