COURT OF CHANCERY OF THE STATE OF DELAWARE

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RE: Garnet O'Marrow and Clarence Gardner vs. Dean P. Roles, Jr. d/b/a, D&M Training C.A. No. 6808-MA

Dear Counsel:

In 2007, Heritage Farms Association, Inc. ("HFA") filed suit in this Court under 10 *Del. C.* § 348 to enjoin Margaret and Dean Roles d/b/a D&M Training from conducting a horse training business on their property, alleging a violation of a restrictive covenant limiting the use of the Roles' property for residential purposes only. The complaint was amended to add several other homeowners in Heritage Farms, including Clarence Gardner and Garnet O'Marrow, as plaintiffs. On October 14, 2008, the parties entered into a "Settlement Agreement and Mutual Release" ("Settlement Agreement")

¹ Heritage Farm Association, Inc. v. Margaret and Dean Roles d/b/a D&M Training, C.A. No. 3053-MG.

that permitted the Roles to continue using their property for "equestrian activities, including, but not limited to, the training, boarding and breeding of horses and that such activity shall not be in violation of the Restrictions referred to in the Roles' deed."²

On August 25, 2011, O'Marrow and Gardner filed this action seeking to enjoin Roles from: (a) expanding his equestrian business beyond the terms of the settlement agreement; (b) constructing a large accessory building on his property without prior approval from HFA; and (c) expanding his easement over Heritage Farms Road as a result of the increased equestrian business on his property. In the alternative, O'Marrow and Gardner are seeking specific performance of the Settlement Agreement, reformation of the Settlement Agreement, and shifting of attorney fees under paragraph 24 of the restrictive covenants and 10 *Del. C.* § 348.

On March 2, 2013, Defendants Roles and Centaur Training L.L.C.³ responded to the Amended Complaint by denying the allegations and asserting waiver, estoppel, laches, *res judicata* or collateral estoppel, and the equitable doctrine of unclean hands as affirmative defenses. Defendants have now moved for summary judgment under Court of Chancery Rule 56 on the grounds that Plaintiffs' claims are barred by the doctrines of *res judicata* and collateral estoppel, and the equitable doctrine of unclean hands. Having reviewed the parties' briefs and the record in this case and in the prior action, I am issuing this draft report in which I conclude that Plaintiffs are now precluded from challenging the expansion of Defendants' equestrian activities and the expansion of

² *Id.* Docket Item ("D.I.") No. 81.

Roles' easement over Heritage Farms Road since Plaintiffs are bound by the Settlement Agreement they executed in 2008. As a result, I recommend that summary judgment should be granted in favor of Defendants as to the first claim in Count I and as to Count II in its entirety. However, I recommend that summary judgment should be denied as matter of law as to the second claim in Count I because *res judicata* and collateral estoppel do not apply to this claim, and the genuine issues of material fact exist whether Plaintiffs have come to Court with unclean hands as Defendants now allege.⁴

I. FACTUAL BACKGROUND⁵ AND PROCEDURAL HISTORY

O'Marrow, Gardner, and Roles are neighbors and property owners in the small community of Heritage Farms near Bridgeville, Delaware. Centaur Training L.L.C. is a limited liability company owned and operated by Roles to conduct his horse training and boarding business. Heritage Farm Road is the paved road providing access to all of the parcels in the community. A prior action between the parties resolved by a settlement agreement in 2008 allowed Roles to continue his commercial equestrian business on his property, but limited to fifteen (15) the number of horses owned by persons other than Roles and his wife on their property and prohibited the delivery of horses to the Roles' property after 9:00 p.m. The agreement also contained provisions for: (1) an annual road maintenance assessment toward which the Roles were to pay \$750.00 each year while the

³ On December 28, 2011, Plaintiffs requested leave to amend their Verified Complaint to add Centaur Training, L.L.C. as a party defendant after Plaintiffs learned the name of the company under which Roles was conducting his business. D.I. No. 11.

⁴ Because Defendants did not discuss Counts III-V of the Amended Complaint in their summary judgment motion, I have not addressed them in my draft report.

⁵ These are undisputed facts taken from the pleadings.

other property owners were each to pay \$250.00; (2) an annual accounting by HFA for all expenditures made to maintain Heritage Farm Road; and (3) other special assessments regarding road improvements.

In 2011, after requesting and receiving some accountings from HFA that Roles deemed insufficient or unsatisfactory, Roles notified HFA that it was in breach of the Settlement Agreement, refused to pay his triple assessment to HFA, and instead proffered a check in the amount of \$250.00. On June 8, 2011, Roles applied to Sussex County for a building permit to build a "Metal Building with Frabric [sic] on it, Storage Only for Farm Use" on his property. Roles now admits that he did not submit plans for the accessory building to HFA's "Board of Governors" for approval prior to its construction, but he denies that such an entity exists.

On August 25, 2011, Plaintiffs filed their Verified Complaint and a Motion for Preliminary Injunction or in the Alternative Temporary Restraining Order ("TRO").⁸ The application for the TRO was denied by Vice Chancellor Glasscock on September 1, 2011,⁹ and the case was subsequently reassigned to me.¹⁰ A motion to amend the complaint was granted on January 23, 2012.¹¹ After the parties conducted discovery, Defendants filed their motion for summary judgment on October 15, 2012.¹² Following the completion of parties' briefing on this motion, the parties stipulated to the production

⁶ Answer to Amended Complaint at ¶ 18. D.I. No. 16.

⁷ *Id.* at $\P \ \P \ 20-21$.

⁸ See D.I. No. 1.

⁹ See D.I. No. 6.

¹⁰ See D.I. No. 7.

¹¹ See D.I. No. 14.

¹² See D.I. No. 29.

and exchange of confidential information, which information was subsequently presented to the Court in connection with Defendants' briefing.¹³

II. ANALYSIS

A. Summary Judgment Standard

The Court will grant summary judgment under Rule 56 where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Williams v. Geier, 671 A.2d 1368 (Del. 1996). In ruling on a motion for summary judgment, the Court must consider the facts in a light most favorable to the non-moving party. Twin Bridges Ltd. P'ship v. Draper, 2007 WL 2744609, at *8 (Del. Ch. Sept. 14, 2007) (citing Ct. Ch.R. 56(c)). If the moving party meets its initial burden of showing that a genuine material issue of fact does not exist, then the burden shifts to the non-moving party to demonstrate that there is a material issue of fact in dispute. See Moore v. Sizemore, 405 A.2d 679, 681 (Del. 1979).

Defendants Roles and Centaur assert that Plaintiffs' claims are barred by the doctrine of *res judicata* and/or collateral estoppel because Plaintiffs are attempting to bring a second suit based on the same cause of action as the prior suit that was settled on October 24, 2008. According to Defendants, a settlement agreement approved by the Court has the same *res judicata* effect as a final judgment on the merits. Defendants also argue that Plaintiffs have come to Court with unclean hands as they breached the Settlement Agreement by: (1) not filing a stipulation of dismissal of the prior action within five days of execution of the Settlement Agreement, as requirement by Paragraph 11 of the

¹³ See D.I. Nos. 35 & 37.

Agreement; (2) refusing to negotiate in good faith a new set of restrictive covenants for Heritage Farms, as required by Paragraph 9 of the Agreement; and (3) failing to complete an annual accounting of all expenditures made to maintain Heritage Farms Road, as required by Paragraph 5 of the Agreement. Defendants also allege that Plaintiffs have unclean hands because they have violated the restrictive covenants that they now seek to enforce against Defendants by subdividing a parcel (Plaintiff Gardner) and operating a business on a parcel (Plaintiff O'Marrow).

Plaintiffs, on the other hand, maintain that the doctrines of res judicata and collateral estoppel do not apply to settlement agreements and, even if they did, the elements of either res judicata or collateral estoppel have not been satisfied here. They maintain, moreover, that Defendant Roles materially breached the Settlement Agreement when he unilaterally decided to stop paying the triple assessment for road maintenance, and that a material question of fact regarding who was the first to breach the Settlement Agreement precludes summary judgment. Plaintiffs also argue that they do not come to Court with unclean hands because Defendants' counsel also failed to follow up on the requirement of filing a stipulation of dismissal, Roles refused to attend a meeting with HFA to discuss the restrictive covenants, and HFA had no further duty to provide an accounting to Roles after he breached the Settlement Agreement by not paying his triple assessment. Further, Plaintiffs argue that the limited business O'Marrow conducts on his property breeding and selling horses does not compare to the scope of Defendants' equestrian operations on Roles' property, including the newly constructed riding arena.

B. Res Judicata and Collateral Estoppel

The party asserting that the doctrine of *res judicata* bars a subsequent action must demonstrate that: (1) the court making the prior adjudication had jurisdiction; (2) the parties in the current action are either the same parties or in privity with the parties in the prior action; (3) the prior adjudication was final; (4) the causes of action were the same in both cases or the issues decided in the prior action were the same as those raised in the present case; and (5) the issues in the prior action were decided adversely to the party's contention in the present case. See *Hendry v. Hendry*, 2006 WL 4804019, at *8 (Del. Ch. May 30, 2006). *Res judicata* constitutes a bar on all claims that were litigated or which could have been litigated in the earlier action. *See One Virginia Avenue Condominium Assoc. v. Reed*, 2005 WL 1924195, at *7 (Del. Ch. Aug. 8, 2005) (citing *Trans World Airlines, Inc. v. Hughes*, 317 A.2d 114, 118 (Del. 1974)).

More limited in scope than the doctrine of *res judicata*, collateral estoppel bars relitigation of issues of fact previously adjudicated. *See Betts v. Townsends, Inc.*, 765 A.2d 531, 534 (Del. 2000). Here, Defendants argue that collateral estoppel bars Plaintiffs from relitigating the issue whether Defendants' use of Roles' property for equestrian-related business activities violates the restrictive covenants in Roles' deed.

While issue preclusion doctrines have been raised by Defendants as the legal basis for their summary judgment motion, because Plaintiffs have also requested specific performance of the Settlement Agreement as an alternative pleading in Count III, it seems more efficient for the Court to decide the summary judgment motion primarily on the basis of the contract between the parties, i.e., the Settlement Agreement, rather than apply the doctrines of *res judicata* and collateral estoppel to Plaintiffs' requests for injunctive

relief. To the extent that the parties resolved certain issues by settlement in the previous action, they are bound by their agreement and any breach of that agreement is subject to enforcement by this Court. Therefore, it is necessary to examine closely the pleadings in No. 3503-MG and the resulting Settlement Agreement.

On October 23, 2007, an Amended Complaint in No. 3053-MG was filed by HFA and several individual homeowners, including Plaintiffs O'Marrow and Gardner, claiming that the Roles were conducting a horse training business on their property, and were in violation of following two restrictive covenants allegedly running with the land and binding all properties in Heritage Farm:

1. Each parcel or given land area located at Heritage Farm Association (hereinafter to be referred to as HFA), shall be solely and exclusively used for residential purposes. No structure improvements, except as hereinafter provided, shall be erected, altered, placed used or permitted to remain upon any such numbered parcel thereof.

14a. No outside toilets shall be constructed on any parcel. 14

In their Answer to Amended Complaint and Counterclaim, the Roles denied the allegations, claiming that "residential purposes" allowed home occupations and that the restrictive covenants were ambiguous because they failed to define the term "residential purposes" and therefore could not be enforced. On January 29, 2008, the date scheduled for trial, the parties reached an agreement, the basic terms of which were read into the record. The transcript of this proceeding demonstrates that the agreement was

¹⁶ *Id.*, D.I. No. 69.

¹⁴ No. 3053-MG, D.I. No. 46.

¹⁵ Id., D.I. No. 51. The Roles did not address Plaintiffs' additional claim concerning the outdoor toilet other than to state that it had been removed from their property.

accepted by the Court as a final resolution of the litigation, as reflected by the colloquy below.¹⁷

THE COURT: Now, this is an agreement in principle. Let me make sure I understand. Are these broad outlines now an enforceable agreement among the parties, and you're going to work out the details?

MR. SERGOVIC: Right. It's an agreement in principle, but we want to reduce it to a final writing.

THE COURT: I understand that. But what I want to make sure is, what will remain now, if there's a disagreement, it's a disagreement over the terms of the agreement, not a disagreement over the ---

MR. SERGOVIC: Over the principles.

MR. BERL: That's correct.

THE COURT: Over the principles. So we're not going to go back – if there's some misunderstanding, you understand that I will interpret the agreement as you give it to me here; I won't go back and retry the case. Do you understand that?

MR. SERGOVIC: That's correct.

MR. BERL: That's correct.

THE COURT: All right. So long as you understand that what's on the record is binding, with the one caveat that you are going to reduce it to a writing and there may be some little –

MR. SERGOVIC: Tweaking.

THE COURT: All right, understood.¹⁸

Several months later, on October 24, 2008, the parties' fully executed Settlement Agreement was filed in the Court. ¹⁹ The Agreement included the following pertinent provisions:

4. **PAYMENT OF ASSESSMENTS**. In consideration of the mutual promises contained herein, the Roles agree to pay the Heritage Farm Association, Inc. ("HFA") Seven Hundred Fifty Dollars (\$750.00) in the form of an annual assessment, the first annual assessment to which this obligation applies shall be due within thirty (30) days of execution of this Settlement Agreement to be applied towards the maintenance of the common road known as Heritage Farm Road. Clarence and Ursula Gardner, Garnet and Mary Ann O'Marrow, and Jeff and Penny Alloway shall be responsible to pay Two Hundred Fifty Dollars (\$250.00) per lot in the form of an annual assessment, the first annual assessment

¹⁷ See Opening Brief in Support of Defendant's Motion for Summary Judgment, Exhibit 16.

¹⁸ *Id*.

¹⁹ No. 3053-MG, D.I. No. 81.

to which this obligation applies shall be due within thirty (30) days of execution of this Settlement Agreement to be applied towards the maintenance of the common road known as Heritage Farm Road. After 2008, the assessment shall be due January 30th of each subsequent year in the same amount for each of the parties or to the successor in ownership of their respective lots, which utilize Heritage Farm Road for access to the four (4) lots as follows: ..., unless unanimously modified by the owners of Lots.

* * * * * * * * * * *

- 6. **DELIVERY OF HORSES**. The Roles agree that no deliveries of horses to their property, via horse trailer or motorized vehicle, shall be made after 9:00 p.m. by third parties. Any horses personally owned by the Roles or their successors or assigns, however, are hereby specifically excluded from this restriction.
- 7. **QUANTITY OF HORSES**. The Roles agree that there shall be no more than fifteen (15) horses owned by persons other than the Roles, or their successors in interest, on the Roles' property ..., for the purposes of their equestrian business.
- 8. **USE OF PROPERTY**. The parties agree that the Roles may continue to utilize their property ... for the purposes of engaging in equestrian activities, including, but not limited to, the training, boarding and breeding of horses and that such activity shall not be in violation of the Restrictions referred to in the Roles' Deed.
- 9. **RESTRICTIVE COVENANTS**. The parties mutually agree to attempt to negotiate in good faith a set of restrictive covenants for the Heritage Farms subdivision that are mutually agreeable and compatible with the uses made by the parties for the two (2) years preceding the filing of the Law Suit.²⁰

The above language demonstrates that the parties contractually agreed to permit the Roles to continue using their property in Heritage Farms for equestrian activities, subject only to limitations on the number of horses owned by other people that the Roles could have on their parcel and on the hours of the day when those horses could be delivered to the Roles' property. In addition, the Roles were required to pay treble the amount of money other homeowners in Heritage Farms were required to pay for maintaining Heritage Farms Road. The above language also demonstrates that the parties anticipated that the equestrian activities on the Roles' parcel might expand beyond the training, boarding and

breeding of horses that was alleged in No. 3053-MG because the Settlement Agreement used the phrase "including, but not limited to" before enumerating those specific equestrian activities.

Plaintiffs now cannot seek an injunction preventing Defendants from expanding their commercial equestrian business on Roles' property because Plaintiffs bargained away their right to complain about Roles' use of his property for such activities when they executed the Settlement Agreement. Similarly, they cannot seek to enjoin Defendants' use of Heritage Farm Road for their commercial equestrian business since the Settlement Agreement only prohibits the delivery of horses to Roles' property after 9:00 p.m., and there has been no allegation that this provision has been breached. Therefore, summary judgment should be granted in favor of Defendants as a matter of law as to the first claim in Count 1 and as to Count II.

Plaintiffs' claim that Defendants have violated the restrictive covenants applicable to Roles' property by constructing a large accessory building without HFA approval requires closer examination. In support of their summary judgment motion, Defendants now argue that it was forseeable that Defendants might expand the equestrian business, including expanding the buildings on Roles' property and, therefore, Plaintiffs should have raised this issue in the prior litigation or should have bargained for limits on such expansion in the Settlement Agreement. I understand Defendants' argument as raising the defense of *res judicata* to this claim and, at the same time, as an implicit admission

²⁰ Amended Complaint, C.A. No. 6808-MA, Exhibit B at 3-5.

that limiting Defendants' ability to construct accessory buildings on Roles' property was not encompassed within the scope of the Settlement Agreement.

It appears, however, that the doctrine of *res judicata* is not as broad as Defendants now argue:

the doctrine of *res judicata* is available as a defense "... if the pleadings framing the issues in the first action would have permitted the raising of the issue sought to be raised in the second action, and if the facts were known, or could have been known to the plaintiff in the second action at the time of the first action"

Schlaeppi v. Delaware Trust Co., 525 A.2d 562, 565 (Del. Ch. 1986) (quoting

Ezzes v. Ackerman, 234 A.2d 444, 445-46 (Del. 1967)). The pleadings framing the first action, No. 3053-MG, were based on the Roles' use of their property and the first paragraph of the restrictive covenants in the Roles' deed, which restricts the use of their property to "residential purposes." There are two other restrictive covenants in the deed that pertain to accessory buildings:

- 6. An accessory building being a subordinate building the use of which is customarily incidental to that of any principal building and is used for an accessory use and is located upon the same parcel as the single family dwelling may also be constructed upon each numbered parcel. The accessory building shall not exceed one story in height and shall be solely in connection with the single family dwelling, except with final approval of HFA.
- 19. For the purpose of further insuring the development of lands comprehended with HFA as a residential [sic] of high standards, the power to control buildings, structure or improvements placed on each lot or given land area therein shall be in the same as hereby invested in HFA Property Owners Association and its successors. Approval must be granted by the Board of Governor. All outbuildings shall be similar in color and construction to the existing barns and buildings located on HFA.²²

²² Id.

²¹ Plaintiff's Answering Brief in Opposition to Defendant's Motion for Summary Judgment, Exhibit C.

At the time of the first action in 2007, the pleadings as framed would not have allowed Plaintiffs to raise the issue of accessory buildings without referring to the pertinent restrictive covenant. Furthermore, Plaintiffs did not then know and could not have known that four years later Defendant Roles would construct a large accessory building on his property without first seeking HFA approval. Therefore, the doctrine of *res judicata* does not preclude Plaintiffs from raising this issue in the present action. In light of Defendants' admission, Plaintiffs are not precluded by the Settlement Agreement from challenging the large accessory building as a violation of the deed restrictions.

Nevertheless, Defendants also argue that "[he] who comes into equity must do so with clean hands." They contend that Plaintiffs have unclean hands because they violated the Settlement Agreement in several ways, and violated the restrictive covenants by subdividing their property without prior approval (Gardner) and operating a business raising and selling horses on their property (O'Marrow) in Heritage Farms.

Courts have broad discretion in applying the doctrine of unclean hands:

While extensive, the discretion of the Court is by no means absolute. Doctrinally there are a number of limitations on the application of the maxim. For instance, in order for the doctrine to apply in the first place the improper conduct must relate directly to the underlying litigation. The standard, as applied by the Court of Chancery, is that the inequitable conduct must have an "immediate and necessary" relation to the claims under which relief is sought. To operate otherwise would invite courts to act in a constabulary rather than judicial capacity. In addition, some courts

²³ Opening Brief in Support of Defendant's Motion for Summary Judgment, at 21 (quoting *Kousi v. Sugahara*, 1991 WL 248408 at *3 (Del. Ch. Nov. 21, 1991)).

have held that the inequitable behavior attributable to the unclean litigant must be directed at, or be the concern of, an interested party (as opposed to any third party.²⁴

It appears from the sparse record before me that both parties may have failed to fulfill some of their obligations under the Settlement Agreement although there is a dispute as to which party allegedly breached the Agreement first.

Furthermore, there is no indication that the alleged inequitable behavior attributable to O'Marrow or Gardner was directed at or a concern of Defendants.

Therefore, I recommend that summary judgment should be denied as to the second claim in Count I because Plaintiffs are not precluded as a matter of law from being this claim and material questions of fact exist whether the alleged misdeeds of the Plaintiffs warrant the application of the equitable doctrine of unclean hands.

For the foregoing reasons, I recommend that Defendants' motion for summary judgment should be granted as to the first claim of Count I and as to Count II in its entirety, and should be denied as to the second claim of Count I.

Sincerely,

/s/ Kim E. Ayvazian

Kim E. Ayvazian Master in Chancery

²⁴ Nakahara v. NS 1991 American Trust, 718 A.2d 518, 523 (Del. Ch. 1998) (footnotes omitted).