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IN THE SUPREME COURT OF THE STATE OF DELAWARE

CONCERNED CITIZENS OF THE ESTATES OF FAIRWAY VILLAGE, An unincorporated association, JULIUS H. SOLOMON and PEGGY A. SOLOMON, his wife, EDWARD D. LEARY and LISA P. TORRINI LEARY, his wife, KENNETH P. SMITH And DENISE M. SMITH, his wife, and TERRY L. THORNES and CARMELA M. THORNES, his wife,	:	**No.: 332, 2020**
Plaintiffs Below/ Appellants,	:	ON APPEAL FROM THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN No. 2017-0924-JRS
V.	:	
FAIRWAY CAP, LLC AND FAIRWAY VILLAGE CONSTRUCTION, INC.,	:	
Defendants Below/ Appellees.	:	

REPLY BRIEF OF PLAINTIFFS BELOW/APPELLANTS

HUDSON, JONES, JAYWORK & FISHER, LLC

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I. THE ORIGINAL DEVELOPER NEVER INTENDED TO ALLOW FOR A RENTAL APARTMENT COMPLEX.

In its Answering Brief Fairway Cap cites to Delaware's long adherence to the objective theory of contracts, determining intent by examining the four corners of the document, and giving effect to all of its provisions. That approach has been nuanced in recent years by the Courts desire to look at the "big picture"[1]. That is reflected in *Chicago Bridge & Iron Company N.V. v. Westinghouse Electric Company LLC*, 166 A.3d 912 (Del. Supr. 2017)("In giving sensible life to a real-world contract, Courts must read the specific provisions of the contract in light of the entire contract"), *Schneider National Carriers v. Kuntz*, 2018 Del. Ch. LEXIS 1403 (Del. Ch., December 20, 2018)(looking at a contract from a distance insures that neither side's arguments are in conflict with the spirit of the overall transaction), and so that the parties' expectations and shared intentions are clarified consistent with the contract language adopted when the contract was formed. *LSVC Holdings, LLC v. Vestcom Parent Holdings, Inc.*, 2017 Del. Ch. LEXIS 865 (Del. Ch., December 29, 2017); *Certain Underwriters at Lloyds, London v. Chemtura Corporation*, 160 A. 3d 457, 468 (Del. Supr. 2017).

But having recognized the need to identify the agreed-upon intentions of the

[1] That, in fact, was the Vice Chancellor's observation in considering whether or not to issue a Preliminary Injunction (A-53-54).

parties, Fairway Cap reveals its true position – that there is no language specifically prohibiting 76% of the condominium units being retained by the developer for an apartment rental complex (Answering Brief, Page 19). That position is far too narrow. There is admittedly no language specifically prohibiting Fairway Cap from building to own and lease. There is, however, language prohibiting Fairway Cap (and everyone else) from operating a business venture within Fairway Village. Although the Declaration permits an owner of a unit to rent it, Section 9(f) of the Declaration prohibits the much larger business contemplated by Fairway Cap[2]. There is no question that a tenant under a lease is using a condo for residential purposes, but only the operation of a *Wawa* in the community building would be a more obvious commercial venture than a commercial apartment complex. The Declaration is void of any language that would alert purchasers of the existence of such an enterprise. These are clearly the types of situations former Chancellor Brown had in mind in *Council of Unit Owners of Pilot Point Condominium v. Realty Growth Investors*, 436 A.2d 1268, 1277 (Del. Ch. 1981) *aff'd. in part* 453 A.2d 450 (Del. Supr. 1982) when he spoke of the need for developers to clearly state their intentions so that owners know in

[2] "Except for residential use permitted by paragraph (a) of this Section, no industry, business, trade, occupation or otherwise designed for profit, altruism, exploration or otherwise shall be conducted, maintained or permitted on any part of the Property, nor shall be conducted, maintained or permitted on any part of the Property" (A-0146).

advance that the entire regime may be changed at any time.

The Homeowners made clear through the testimony of Edward Tarlov, Esquire that the enabling documents were drafted with the intention that the condominium units would be built and sold to third parties (A-270), that he gave no consideration whatsoever to a large rental complex (A-270), that he specifically advised the previous developer that the entire condominium could not be converted into an apartment complex (A-273), and that his expectation was that the developer would complete the project and move on, as is typically the case (A-272). The history for 10 years following the establishment of Fairway Village was entirely consistent with his testimony.

Fairway Cap acknowledged that the "initial intent" was to sell units (Answering Brief, Page 21), but suggests that circumstances compelled Fairway Cap to change directions. That claim of sluggish sales, however, was nothing more than a pretext to justify the rental complex. By 2017[3] the housing market had rebounded from the Great Recession, and Capano's own expert, Charles Darrell, described sales as "brisk" (AR-11, pages 42-43; AR-12, page 47). He predicted that Fairway Cap would be able to sell 24 units per year (AR-13, pages 50-51) – the exact same number the developer's principal set as a goal during his deposition and trial testimony (AR-14, page 21; A-510). In addition, Robert Lisle, Insight's

[3] The "effective date" of Charles Darrell's report was June 1, 2017 (AR-10, page 21).

CEO, had described the market as "robust" and had used the same "brisk" description for sales of condominium units, and had expressed interest at the same time about acquiring additional building sites in Fairway Village (AR-3-4). But Capano also admitted that he had not even read his expert's report because he never had any intention of selling the remaining units (AR-14, page 21; AR-15, page 22). Nor did he ever consider whether the enabling documents permitted rentals of unsold units since he didn't know what the documents said (AR-16, page 53).

Fairway Cap attempts to minimize Tarlov's testimony, calling it "inconclusive". But it was nothing of the sort. The testimony of the draftsman clearly established the intention to build and sell each and every condominium unit – an intention reflected in Schedule D (A-169-171). Even assuming difficulty with that plan later on, the evidence at the time the contract was made with the recordation of the Declaration and Code of Regulations, clearly reflected the intention to sell condominiums to third parties.

Fairway Cap argues that the documents themselves, having been available to purchasers, were sufficient notice of the epic change in direction. But as Ms. Leary testified, the owners were never told that the condominium would become a rental apartment complex (A-373). Indeed, she and Homeowner Hal Solomon (both lawyers) read the documents themselves without any suspicion of what was

to come (A-373; A-418). Mr. Solomon added that his settlement attorney never mentioned it either (A-418). Yet Fairway Cap's argument is that some 200 homeowners (and their settlement attorneys) are bound by its interpretation that a rental complex should have been apparent from the outset.

Nothing then, or in the 10 years that followed, foretold the changes undertaken by Fairway Cap, and reasonable men and women, such as individuals buying both condos and single-family dwellings, could not have believed that to be the case.

II. FAIRWAY CAP'S RENTAL APARTMENT COMPLEX IS A BREACH OF CONTRACT BECAUSE IT ELIMINATES THE AVAILABILITY OF REASONABLE MORTGAGE FINANCING.

Fairway Cap approached the mortgage issue in the same way it approached the previous argument – arguing that there is nothing in the enabling documents that requires that federally-backed mortgages be available. As noted, though, Section 15.1 of the condominium's Code of Regulations clearly evidences the importance of those mortgages, authorizing unilateral amendments to documents in order to ensure compliance with Freddie Mac/Fannie Mae requirements, and Fairway Cap's own expert confirmed that the majority of homeowners in the Bethany Beach/Ocean View/Millville area (including Fairway Village) use those same federally-backed mortgages (A-533).

But the importance of the issue goes well beyond the Code of Regulations. The larger question as framed by the Homeowners is whether the intent of the original contract sanctioned a situation in which every reasonable mortgage product would be unavailable, thus hamstringing existing owners from refinancing or selling. The undisputed facts established that the community became non-conforming once Fairway Cap embarked on its plans, and the Court recognized and accepted that reality (Opinion, Pages 12-13). Other mortgage options (with additional points and higher interest rates triggering significantly higher interest payments) are so onerous that they cannot reasonably be considered acceptable

alternatives. As the Homeowners' expert, Joe Della Torre, testified, he was unable to locate a single lender willing to loan money in Fairway Village (A-566, A-312), something Fairway Cap's expert never even attempted (A-544).

Fairway Cap instead points to the Florida condominium in which Ms. Leary and her husband also own a unit, and its restriction on ownership so as to protect against being deemed "nonconforming", and suffering the same fate as Fairway Village (Answering Brief, Pages 27-28). But as Ms. Leary testified, that limitation was enacted after the condominium was formed, and for that precise reason (A-411-413). Unlike Fairway Village, that regime was no longer under the permanent control of a developer and had the ability to enact controls necessary to preserve mortgage financing. Fairway Cap holds out such a limitation as an option, but conveniently ignores the fact that because it owns 76% of the condominium units no such restriction can ever be enacted!

The Homeowners are not, as Fairway Cap suggests, asking the Court to rewrite the contract. They are asking that the original contract be interpreted consistent with the intent of the draftsman so that units are sold to third parties, thereby preserving the availability of federally-backed mortgages. It is inconceivable that the developers of Fairway Village intended a condominium in which federally-backed mortgages would be rendered unavailable, and that is exactly what an objective, reasonable third party would have envisioned.

III. THE RENTAL APARTMENT COMPLEX ALLOWS FAIRWAY CAP TO AVOID ITS CONTRACTUAL OBLIGATIONS TO THE HOMEOWNERS AND WILL PERMIT FAIRWAY CAP TO VIOLATE ITS OBLIGATIONS IN THE FUTURE.

The Homeowners' third argument detailed past, present, and likely future abuses on the part of Fairway Cap stemming from its absolute control over the condominium. The above fell into three categories – financial issues, control issues, and actual mismanagement.

As noted, Section 5.7 of the Constitution exempted the developer from all financial obligations in both the condominium and the single-family section of Fairway Village. That includes regular dues and assessments, initial contributions upon the anticipated first sale of a unit (Section 5.9 of the Constitution), contributions to reserves (Section 5.10), and the like. The Code of Regulations requires similar payments to benefit the condominium (A-195-196).

Fairway Cap argued somewhat paternalistically that since it has made its payments thus far, the Homeowners needn't worry. It claims now that it believes the exception no longer applies and was only applicable when it was actively seeking to sell units.[4] The Trial Court concluded that the Fairway Cap units remain subject to obligations to make payments, but failed to explain that conclusion, or to explain why Section 5.7 would no longer serve as an exemption.

[4] That explanation, which appears at Page 36 of the Answering Brief, was never offered before now.

The fact of the matter is that despite having had the opportunity to easily eliminate the exemption, Fairway Cap has failed to do so. Section 5.7 remains part of the Constitution, and Fairway Cap is free at any time to stop making payments, regardless of whether it has paid in the past. The Homeowners' concern was expressed in trial testimony, when it was pointed out that although an association might survive one or two delinquent owners, the loss of income from 76% of the ownership will be far different (A-504, A-421). Even Fairway Cap's real estate expert recognized those problems (A-502-503). The ability on the part of Fairway Cap to wreak financial havoc on the condominium and the Homeowners Association cannot be understated, and cannot possibly have been the intention of the original developer.

The Homeowners also argued in their Opening Brief that the ownership of 76% of the condominium units completely undermined the plan established in the enabling documents for the developer to complete construction and development and turn over the community to the Homeowners. Fairway Cap's unsurprising response is that there is nothing in the enabling documents preventing it from owning a large percentage of units and exercising dominance over the community.

But that response begs the question. If all of the provisions of the enabling documents are to have meaning, the consequences of Fairway Cap's complete control of the Condo Association and Homeowners Association cannot be

reconciled. Fairway Cap suggests that the Homeowners may not have envisioned one party owning 76% of the units. That is absolutely correct, since ownership by Fairway Cap of such a large majority of units renders illusory the plan so clearly set forth in the enabling documents that provides for the developer to turn over the governance of Fairway Village to third party owners upon completion.

It cannot be reasonably disputed that the intention was for the developer to complete its work and then turn the project over to the purchasers of condominium units or single-family dwellings. That plan is set forth early in the Constitution, as follows:

> "WHEREAS, to accomplish these objectives the Community Founder [i.e. the developer] believes that it is in the best interests of the Community for the Community Founder to maintain a significant and influential role in the implementation of the Community Plan and the Community Founder has therefore retained numerous rights and will exercise significant control and influence over the Property until the development process has been completed" [emphasis added](A-72).

The Constitution also reflected that plan of transition in the developer's Reservation of Rights. Section A-101 of Appendix 2 of the Constitution reads, in pertinent part:

> "The Community Founders' Rights and Obligations shall extend until the sooner to occur of (i) the conveyance of all Living Units contained or to be contained within the Community to Owners other than the Community Founder or Participating Builders, or (ii) twenty (20) years after the

recordation of this Community Constitution, …" (A-123).

Finally, Fairway Cap's rather dubious after-the-fact statement that it believed the payment exemption lasted only during the development stage is Fairway Cap's recognition that there was a development period, to be followed by a turnover to the property owners. Fairway Cap cannot "cherry pick" portions of the enabling documents that it believes support its commercial venture. The entirety of the enabling documents must have meaning, and Fairway Cap's apartment complex completely undermines the plan to turn the community over to the owners to govern.

The third aspect of this argument is the documented mismanagement by Fairway Cap that has already taken place, and which remains unchecked as a result of Fairway Cap's ownership interest. Fairway Cap responded by suggesting that general corporate duties of care and the Delaware Uniform Common Interest Ownership Act ("DUCIOA") exist to ensure compliance.

But since the existence of those same duties and statutes did not prevent Fairway Cap from previous instances of mismanagement, it is difficult to imagine any difference in Fairway Cap's cavalier attitude going forward. The mismanagement claims by the Homeowners were not at all speculative. They pointed out the failure to elect members to council despite the advice of counsel (Opening Brief, Page 35), the failure to hold annual meetings (Opening Brief, Page

35) the failure to create legally-required reserve funds (Opening Brief, Page 36) the improper "borrowing" from reserves to fund operations (Opening Brief, Pages 36-37), and threatening the security of Fairway Village amenities by applying mortgage funds to other projects (Opening Brief, Page 38). All of those events are similarly in violation of the same duties of care and DUCIOA laws which Fairway Cap offers as an obstacle to further violations. Yet it is clear that none would likely have occurred but for the Fairway Cap ownership, and cannot have been envisioned by either the original developer or subsequent owners.

Finally, Fairway Cap suggests that the cash shortfall in June 2018 was the result of unreasonable delays on the part of the Town of Ocean View in issuing building permits (Page 38). But that is completely contrary to the testimony of Fairway Cap's own property manager, Beth Umstead, who affirmatively stated that Fairway Cap "held back" certain units (A-652). By holding units out, the necessary initial payments under Section 5.9 were not available to cover actual community expenses. The shortfall, which led to the further impropriety of borrowing from reserves, was a very real consequence of Fairway Cap mismanagement.

IV. THE CHANCERY COURT ERRED IN AWARDING DAMAGES AFTER HAVING APPROVED THE RELEASE OF AN INJUNCTION BOND.

In its Opening Brief the Homeowners argued that Fairway Cap was not entitled to damages for the "wrongfully issued" injunction after the Trial Court had ordered the previously-posted bond released, with the consent of Fairway Cap. That argument was based on the "Injunction Bond Rule" – "the bond is the limit of the damages the defendant can obtain for a wrongful injunction". *Emerald Partners v. Berlin*, 712 A.2d 1006, 1011 (Del. Ch. 1997)(citations omitted). Fairway Cap's response is essentially that the existence of a bond or other security is immaterial, and that a wrongfully enjoined party may recover any amount of damages if no security exists. That argument lacks support and completely ignores *Emerald Partners* – Delaware's leading case defining the Injunction Bond Rule and confirming its applicability in Delaware.

The original injunction approved in *Emerald Partners* required security in the amount of $500,000.00. *Emerald's* subsequent request to substitute stock with a lesser value was approved by the Defendant, knowing that its damages might be greater. The Court later ruled that the Defendant was limited to the actual value of the substituted security (not the original $500,000.00), and would not entertain damages in excess of its actual value. Similarly, Fairway Cap settled with Insight

and agreed to the release of the bond, knowing that it was sole security for the injunction.

Fairway Cap's position makes no sense. It agrees that an enjoined party is limited to damages capped at the value of security, but only if security is actually posted[5]. Had the Chancery Court set a substitute bond in the amount of $1,000.00 as suggested by Homeowners' counsel when the surety bond was released, Fairway Cap, by its own admission, would have been limited to a recovery in that amount. Had the Court required security in the nominal amount of $1.00, Fairway Cap's damages would have been limited to that nominal figure. But Fairway Cap then argues that in the absence of any security, its damages can be potentially unlimited. That is patently absurd.

Fairway Cap argues that the Homeowners accepted the benefit of the injunction with full knowledge of the damages for which they might become liable (Page 46). But that is not accurate. The Homeowners accepted the injunction, but did not have the capability of mustering security in the amount of $354,000.00. The injunction became effective only after Insight posted the surety bond, and Fairway Cap knew perfectly well that it was releasing the collateral for the injunction. Not only did Fairway Cap agree to the release of the bond, it never

[5] "When the court requires the applicant for a preliminary injunction to post security…" (Answering Brief, Page 41). And later, "…when security is posted, the enjoined is limited to damages capped at the value of security" (Answering Brief, Page 45)(Emphasis added).

requested that the injunction be lifted. The bond was released on August 14, 2018. It was not until the Opinion was issued in March 2019, some seven months later that the injunction was formally deemed "wrongful". Fairway Cap has only itself to blame for damages which may have accrued during that timeframe.

Although Fairway Cap recognizes the advantage of having an available source for payment of damages, it generally ignores the benefit that a decision on security provides to a plaintiff. As noted in the Opening Brief, that security informs the Plaintiff of the price it might pay if the injunction is wrongfully issued. At the outset the Homeowners and Insight were advised of that price. They chose to accept it by having Insight post the bond – a bond that could have been available to Fairway Cap had it not acquiesced in its cancellation. The Homeowners never sought a "risk free" injunction as Fairway Cap claims (Answering Brief, Page 49). It was Fairway Cap that made it risk free by agreeing to the withdrawal of the bond.

There has never been any question in Delaware that the Injunction Bond Rule limits the recovery to the value of the security actually posted in exchange for an injunction. The Homeowners' Opening Brief cited several cases in which that limitation has been applied. Fairway Cap's position that the absence of security is the equivalent of a blank check simply cannot be reconciled with the law of this State.

CONCLUSION

For the reasons set forth herein and in the Homeowners' Opening Brief, the Decisions by the Vice Chancellor approving the commercial rental complex and imposing damages should be reversed.

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