Wisdom of the Ages

By Phillip Lewis

How long did it take man to become wise? When did *Homo sapiens*—literally, but dubiously, "wise man," or "man the wise"—begin to accrue and abide by wisdom earned from the despair of his own folly and error?

If you believe the science books, the earliest known *hominin* ancestor of modern humans dates to about seven million years ago, but these simple, large-molared creatures had no language, no art, and most importantly, no holdings in real property. Lucy, the famed *Australopithecus afarensis*, who was apparently bipedal but likewise without a permanent address, lived between three and four million years ago. At some point thereafter, the *hominin* tree forked dramatically, with one of the two branches producing the genus *Homo*. These hapless folks appeared in Africa as recently as 200,000 years ago, where the beginnings of a system of real-property ownership was in its earliest stages.[1]

Somewhere along the way on this journey to the present, our more proximate ancestors began to compile and pass down little bits and pieces of wisdom to younger generations as rules and guideposts for daily living. Through the advent of papyrus, rudimentary writing implements, and now Snapchat, this wisdom has been distilled over time into innumerable axioms and proverbs that we live by, teach our children, and largely ignore when it comes to transactions in real property. "An ounce of prevention is worth a pound of cure" is one such example. "Penny wise, pound foolish" is another.

This article, admittedly *avant-garde* and quite groundbreaking in its own right, courageously seeks to tread where others have historically dared not go, to wit—to boldly pair such classical time-honored words of wisdom to modern concepts of real-property law, and thereby find common application between the two disparate worlds that so rarely come together. We'll begin with an aphorism from an ancient Roman poet of the Augustan period.

"The Road to Hell is Paved with Old Restrictions" [2]

If you have a buyer interested in property in an old residential subdivision, it is wise to anticipate that somewhere way back in the chain of title there are restrictions on record. If you have any inkling that the subject property was at one time carved up and sold by a developer, no matter how remote in time, the safest course is to go beyond the standard 40- to 60-year search and track down the restrictions.

A lot of issues I've seen lately (as a litigator) involve developers buying lots and blocks out of these old residential subdivisions and trying to develop the property into apartments or townhomes. As we all know, this course of action calls readily to mind that old shopworn cliché, "Hell hath no fury like a group of people subject to a single-family residential restriction when a builder comes in and tries to start a multi-family use project."[3]

Here's a typical case: What was once a purely residential subdivision has changes on its periphery—some commercial use here; a little multi-family use there. Part of the property has even been zoned for mixed-use development. A developer interested in buying the property looks at all this on the street level and assumes (wrongly) that the property cannot possibly be encumbered by uniform residential restrictions, and likewise believes (again wrongly) that if there are restrictive covenants, they cannot possibly be enforceable.

The first step, of course, is to search the title and determine whether the subject property and the surrounding subdivision were once made subject to restrictions. Even if the restrictions were put on in 1912, or 1928, or anytime well before the period prescribed by the Marketable Title Act, you still need to find them if they exist. The Marketable Title Act, which could provide a defense to enforceability, may not, as a practical matter, help you as much as you'd like to think, which I'll discuss further below.

Let's say you find that the property was once owned by M. Garren & Sons Construction, Inc., and that this wily but mostly astute developer subdivided the property in 1933. Assume for this hypothetical that the restrictions are otherwise enforceable. One of the first questions to ask is whether the restrictions were imposed in connection with a common scheme of development. This is relevant for a number of reasons, one of which is to determine who may be entitled enforce the restrictions.

As we all know, a common scheme of development exists when a developer has, pursuant to a general plan of development, subdivided property and conveyed out lots subject to substantially similar restrictions, whereby the restrictions may be enforced among similarly situated owners.

In general, all owners of similarly restricted lots under a common scheme of development can enforce the restrictions against all other similarly restricted lots. You therefore cannot safely assume that you only have to check the restrictions for the lots that appear in close proximity to the subject property, or only on the plat that contains the subject property. It is possible that the surrounding property that appears on one or more separate plats was part of the common scheme of development, such that these owners may have the right to enforce the restrictions.

Hawthorne v. Realty Syndicate, Inc. [4] is an instructive case in this regard. In *Hawthorne*, the Court of Appeals held that owners in two different subdivision blocks that were separated by a four-lane road were entitled to enforce "substantially similar" restrictive covenants against an owner in one of the blocks because the subdivision was developed according to a common scheme of development. In finding that there was a common scheme of development, the court examined several factors, none of which were determinative standing alone. The court stated: "Blocks 7 and 9 were platted together. Sales of the lots in each tract began at substantially the same time. The restrictions imposed by the deeds to the lots in both tracts are substantially similar. These and other factors . . . support the conclusion that the two blocks were developed as one parcel, subject to common restrictions intended for the mutual benefit of the property owners in both tracts." The court noted that "differences in the general phraseology [in the CCRS] do not themselves defeat the inference of a common plan . . . ." This suggests that minor differences in the wording and content of the CCRs do not necessarily mean that there is not a common scheme of development.

In a recent case I was involved in, what first appeared to be a relatively small restricted area with about ten lots turned out to be part of a sprawling residential subdivision that contained hundreds of similarly restricted lots on dozens of plats. Each of the plats said, "A Portion of Worthmore[5] Subdivision," and it was clear that the developer intended for this to be one large community. Because it would have been next to impossible to amend the restrictions given the sheer numbers involved, it became necessary to file a declaratory-judgment action to establish that the subject property was no longer subject to the restrictions due to a change in circumstances (which happened to be the case).

Whether there is a common scheme of development, and how far the common scheme extends, is not an easy, color-by-numbers analysis. The moral here is to be aware of the possibility of a common scheme of development that might include other similarly restricted owners who could potentially bring an enforcement action against your client if the restrictions are not otherwise resolved.

"Be the Radical Change You Wish to See in the World."[6]

So your client says to you, "There's no way these restrictions can be enforceable, is there? On this lot there's a body shop. On that lot, there's a triplex operating a daycare and tattoo parlor. Over there is a parking lot for an exotic-pet store." For a subdivision with a single-family residential restriction, it seems obvious that there's been a change of circumstances that would render the restrictions unenforceable, but this is not always as straightforward as it seems. Whether there has been a "radical change of circumstances," such that the restrictions are no longer enforceable due to changes within the covenanted area, is an issue that is fraught with misunderstanding and confusion.

North Carolina law holds that restrictive covenants that do not otherwise end by their own terms may be terminated "when changes within the covenanted area are so radical as practically to destroy the essential objects and purposes of the agreement." *Medearis v. Trustees of Myers Park Baptist Church*, 148 N.C. App. 1, 6, 558 S.E.2d 199, 203 (2001). "A change in the character of the neighborhood which was intended to be created by restrictions has generally been held to prevent their enforcement in equity where it is no longer possible to accomplish the purpose intended by such covenant . . . ." *Muilenburg v. Blevins*, 242 N.C. 271, 275, 87 S.E.2d 493, 496 (1955).

What I've found is that the average developer's perception of whether there has been a radical change of circumstances, and whether there has actually been a radical change of circumstances, are vastly different things. Under the case law in North Carolina, a "radical change of circumstances" is quite a difficult standard to achieve.

I litigated a case a few years ago up in Blowing Rock, in an old subdivision known as Mayview Park that was up behind the municipal park in town. The restrictive covenants for Mayview Park first appeared on record in 1919 in the individual conveyances of lots by the developer, W. L. Alexander. There were 104 original lots. The restrictions prohibited these lots from being further subdivided, and also imposed a limitation of only one house per original lot. There was also a single-family residential restriction.

Despite the restrictions being on record, a buyer (who eventually became my client) bought a beautiful view lot for the purpose of subdividing it and putting two houses on it. At the time of closing, he believed that the restrictions were no longer enforceable because they had been violated so often, and to such a significant extent. Of the 104 original lots, at least 40 had been subdivided, such that after various reconfigurations and so forth, there were 96 subdivided lots. Nearly 70 homes had been constructed on subdivided lots despite the restriction imposing a limitation of only one house per original lot. Furthermore, there had been a hotel built on a residential lot, as well as 32 condominium units, a townhouse project, and a restaurant (Bistro Roca). The violations had spanned for decades upon decades, with the first lot subdivision occurring in 1927.

Despite all these open and obvious violations, *not a single person* complained a single time until 2007 when this one unwitting guy came along, at which point six or seven of his neighbors jumped up and down, filed a lawsuit, and got an injunction preventing him from moving forward with construction. In response to the lawsuit, I raised a defense that the restrictions were no longer enforceable, and soon we had to name every lot owner in Mayview Park as parties to the litigation.

After two full days of hearings on the trial level, an experienced trial judge called the attorneys back into chambers. He looked at me and said, "You may well win in Raleigh, but I'm not going to tell the rest of these lot owners that their restrictions are not enforceable." He went on to say that based on his years as a real-estate practitioner, he believed that restrictions were a valuable property right, and that he wouldn't be the one to defy the plaintiffs' expectations that the restrictions were enforceable, notwithstanding the many existing violations of the covenants.

My client ultimately prevailed on appeal, but it was anything but a slam dunk. The moral of this story is that it's harder than you might think to demonstrate that "changes within the covenanted area are so radical *as practically to destroy the essential objects and purposes of the agreement*." Do not assume that restrictions are no longer enforceable just because you have several notable violations. Also be aware that changes *outside* the covenanted area are irrelevant for purposes of this analysis.

"**Nature Abhors the Marketable Title Act**"[7]

The Real Property Marketable Title Act (Chapter 47B) sets out that "obsolete restrictions . . . which have been placed on the real property records at remote times in the past often constitute unreasonable restraints on alienation and marketability of real property." Section 47B-2 provides that if a party has a record interest in real property comprised of a 30-year (or longer) chain of recorded documents and nothing appears of record within that 30-year period that is contrary to the party's interest, that party has, under the Act, marketable record title to the real property. Subject to specific exceptions set forth in section 47B-3, the party's interest in the real property is free of any claims or interests which arose or were of record prior to the 30-year period.

I have had several cases recently where there was a good argument that restrictions were unenforceable by virtue of the Marketable Title Act because they occurred so far back in the chain of title, and no reference to the restrictions appeared in the chain for more than 30 years. Still, attorneys for buyers should keep two things in mind: First, there is precious little case law interpreting the Marketable Title Act. In my opinion, there remain important questions in regard to how the Act may be applied—so there is no guarantee of a viable defense under the Act. Second, if your client gets sued over a violation of the restrictive covenants, your assurance to the client

that she will "likely prevail" under the Marketable Title Act after two or more years of litigation may not be much of a consolation.

The moral here is that even if you feel like you have a good defense under the Marketable Title Act, your client might still be buying into a lawsuit if you do not deal with the restrictions prior to closing.

"Those Who Cannot Remember the Past Are Condemned to Make Title Claims"[8]

It's important to bear in mind that simply getting title insurance coverage over restrictions is not a panacea. A title policy, while still the very best policy of insurance you can buy,[9] is not designed to solve all your client's problems if after closing he or she gets nailed with a lawsuit over a set of restrictions.

Let's say you represent a large homebuilding company. The homebuilder buys three prime acres of property subject to restrictions that haven't appeared in the chain of title for 65 years. The title company agrees to insure over the restrictions and the closing goes forward.

Your homebuilder client mobilizes and takes $100,000 worth of lumber and building materials to the site, only to get served with a lawsuit seeking an injunction to stop all building until the court decides whether the restrictions are enforceable. You have to tell your client it might be well in excess of a year before the case is decided by the courts. Your client says, "But I have title insurance." At this point—after closing, and after the lawsuit has been filed—is *not* the time to have a discussion with the client regarding what title insurance will and will not address. The title company has the option to cure under the policy, and is entitled to litigate the matter to a final adjudication, even if that takes a year or two years or longer. Speaking broadly, if the title company is unable to establish that the restrictions are not enforceable for one reason or another, the insured owner is not, at that point, entitled to damages for all her losses, but is instead only entitled to the difference in value for the property with the restrictions and without (up to the amount of policy). While the litigation is pending, the title insurance does not cover carrying costs or reimburse the homebuilder for lost profits and the like.

The moral here is that your client should clearly understand what title insurance does and does not address so the client can make an informed decision about moving forward with closing when re-strictions exist in the chain of title.

"God Helps Those Who Address Restrictive Covenants *Before* Closing"[10]

The best and safest way to address restrictive covenants is *prior to* closing. Yes, there will likely be a cost associated with resolving the restrictions, and yes, it could be time-consuming. Yes, it is possible that some sales may not close because of unresolved issues with re-strictive covenants. But your client will be in a far better position to deal with restrictive covenants before closing than possibly having to address them in the form of a lawsuit after.

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Endnotes

1. Not really. But keep reading.
2. Virgil, Aeneid (ca. 19 BC) ("facilis descensus Averno antiqua restrictiones"). According to his biographer, Virgil received the first ever commission for the sale of real property.
3. William Congreve, The Mourning Bride (Act III, Scene 2) (1697), in which the play's protagonist, a retired government employee with no hobbies and endless time on his hands, leads the valiant charge against an unsuspecting homebuilder who wishes to convert a rundown portion of a residential neighborhood to a series of duplexes.
4. 43 N.C. App. 436, 259 S.E.2d 591 (1979).
5. Names have been changed to protect the innocent.
6. Mahatma Gandhi (1869—1948), Indian activist and right-of-way agent for New Delhi Power & Light.
7. This clever aphorism—horror title actum artificium venale—was first attributed to Greek philosopher and scientist Aristotle, himself no stranger to the world of real estate, who is well known to have dabbled with investments in Cypriot time shares and even had a few vacation rentals.
8. George Santayana, The Life of Reason: The Phases of Human Progress (1905-06). Santayana also once famously said, "An idealist is one who, on noticing that roses smell better than cabbage, concludes that they will also make better soup." Or maybe that was H. L. Mencken.
9. Please send your checks to my attention at 301 S. College St., Suite 2600, Charlotte NC 28202.
10. This venerable phrase most likely originated in Sophocles's play Philoctetes (ca. 409 BC): "And heaven ne'er helps the men who will not act, nor those who fail to obtain waivers from all owners subject to certain restrictions prior to closing."