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THE NECESSARY APPLICATION OF THE CONTRACT CLAUSE TO CASES INVOLVING RESTRICTIVE COVENANTS AND GROUP FAMILY DAY CARE HOMES

Heidi Marie Flinn*

INTRODUCTION

Consider a woman who purchased a condominium ten years ago. To earn extra money, this woman now wishes to start caring for three or four children in her home during the day. Word gets out around the building. The neighbors approach the woman to see if they can persuade her not to operate the day care in the neighborhood because of the extra noise and traffic it would bring. The operator of the new day care understands their concerns, but she persists in opening the new day care because of her financial situation. The neighbors file suit to enjoin the woman from beginning her day care business because it violates a clause in the condominium's bylaws that limits the property to residential use only as a single family dwelling.¹

The operator of the day care home argues that she is not violating the terms in the restrictive covenant,² and, even if she is, the restrictive covenant cannot be enforced because it violates public policies manifested in a variety of state statutes.³ The operator

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1. See, e.g., *Quinones v. Board of Managers*, 673 N.Y.S.2d 450 (App. Div. 1998) (deciding whether owners of a condominium were entitled to an injunction barring the board of managers from taking action against their group family day care home. The ownership agreement contained a clause that stated "[t]he use for which the Unit is intended is residential occupancy, provided that, subject to all applicable governmental laws and regulations, any residential Unit may be used as a professional office if the owner thereof resides therein.").

2. See Dirk Hubbard, *Group Homes and Restrictive Covenants*, 57 U. Mo.-K.C. L. REV. 135, 138 (1988) (citing cases in several jurisdictions, including Missouri, North Carolina, Texas, and Colorado, that find group homes for the mentally retarded constitute a residential use).

3. See *Crane Neck Ass'n v. New York City/Long Island County Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984) (considering section 41.34(f) of New York's Mental Hygiene Law that states "[a] community residence established pursuant to this section and family care homes shall be deemed a family unit, for purposes of local laws and ordinances").

cites many cases where the court denied enforcement of a restrictive covenant due to public policies favoring operation of group homes for the mentally ill.⁴ In response, the neighbors argue that the operator is violating the terms of the restrictive covenant, and that the state cannot override the covenant, a private contract, unless there is a compelling state interest, which does not exist here.

This scenario illustrates some of the issues that arise when restrictive covenants clash with a state's public policy and raises the question of whether, and to what extent, state statutes and judicial imposition of public policy may legitimately interfere with private contractual rights. When courts address whether to deny enforcement of a restrictive covenant as it applies to a group family day care home, a legitimate constitutional issue is not being addressed. State courts are not applying the Contract Clause analysis that is set forth by the United States Supreme Court in *Energy Reserves Group v. Kansas Power & Light Co.*⁵ to determine whether the denial of enforcement of the covenant is constitutional. When group homes for the mentally ill are involved,⁶ some state courts have held that the states have an interest in promoting the deinstitutionalization of the mentally ill and, thus, can deny enforcement of private contracts. Although the results in these cases may be appropriate, the analysis many courts use to reach their holdings is problematic. Only when state legislation prevents enforcement of the covenant against group homes have courts fully recognized that there is a question about the constitutionality of the state's action. Nonetheless, in the more typical situation, courts have denied enforcement in the absence of such legislation. Relying on common law judicial power to deny enforcement of covenants against public policy as reflected in related (but not controlling) statutes, those courts have most often failed to acknowledge any constitutional dimension to their decisions.

In addition, even if the Contract Clause analysis is being applied, it is not being applied correctly because courts are employing public policy in support of group homes for the mentally ill to support

4. See *id.*; see also *Craig v. Bossenbery*, 351 N.W.2d 596 (Mich. Ct. App. 1984); *Deep E. Tex. Reg'l Mental Health and Mental Retardation Servs. v. Kinnear*, 877 S.W.2d 550 (Tex. Ct. App. 1994).

5. 459 U.S. 400 (1983).

6. This Note will look to many cases involving group homes for the mentally ill because they are more numerous than cases involving group day care homes for children. Suits over group homes for the mentally ill are also useful precedent because they provide a more complete background of the public policy surrounding these cases and also of the Contract Clause application.

homes for family day care. Courts should recognize the policies behind family day care independently of the policies in favor of deinstitutionalizing the mentally ill and then determine whether the state has a significant interest in regulating family day care.

This Note argues that courts should apply the Contract Clause analysis⁷ that is set forth by the Supreme Court in *Energy Reserves* to all home based day care cases regardless of whether it is state legislative or judicial action that prevents enforcement of a restrictive covenant.⁸ The conclusion is significant as litigation shifts from group homes to home based day care. Whether the latter are permissible may well depend upon whether courts conceive that they must pass the constitutional test or merely find support in public policy. Applying *Energy Reserves* to these cases allows both the interests of the operators of the group family day care and the interests of the surrounding property owners who are subject to the same restrictive covenants to be considered.⁹ In addition, adopting the Supreme Court's rationale in *Energy Reserves* will ensure that litigation involving home based day care receives separate consideration from those cases on group homes for the mentally ill because of the different policy concerns.¹⁰ In many instances, the rights of the other property owners would be unduly sacrificed because the state is impairing their private right to contract either without a compelling interest or to a greater extent than necessary.

Part I explains the background of restrictive covenants as they apply to group homes and also analyzes the importance of courts' interpretations of the terms found within the covenants. It outlines the Contract Clause analysis, a factor frequently mentioned in restrictive covenant cases, that is set forth by the Supreme Court in *Energy Reserves*.¹¹ Finally, it explains the effect of the Fair Housing Act ("FHA") on this type of litigation. Part II summarizes the

7. The right to enforce a restrictive covenant may be conceived as a property right as well as a contractual right. See *Barrett v. Dawson*, 71 Cal. Rptr. 2d 899 (Ct. App. 1998) (addressing the abrogation of the covenant as a taking of property issue as well as a contractual concern). This Note will only address a restrictive covenant as a contractual right because *Energy Reserves* states the appropriate test. See *infra* Part I.D. In addition, a restrictive covenant is the functional equivalent of a negative easement. See BLACK'S LAW DICTIONARY 1032 (6th ed. 1990) (defining a negative easement as an "easement which restrains a landowner from making certain use of his land which he might otherwise have lawfully done but for that restriction and such easements arise principally by express grant or by implication"). See also *infra* note 13.

8. See *Energy Reserves*, 459 U.S. at 410-12.

9. See *id.*

10. See *id.*

11. 459 U.S. 400 (1983).

cases involving restrictive covenants and group homes. It also reviews litigation involving restrictive covenants and family day care homes. Part III contends that the Contract Clause analysis should be used in all cases involving group homes for child day care. This Note concludes that while it seems that the FHA is becoming the best tool to litigate cases involving covenants and group homes for the mentally ill, the Contract Clause is a tool that must be used to address cases involving child day care homes. The Contract Clause should be used where a court has found a violation of the restrictive covenant but considers whether to abrogate the covenant because of public policy in favor of these child day care homes or because of a state statute on point. This analysis guarantees that all parties will have their rights adequately examined.

I. HISTORY OF RESTRICTIVE COVENANTS AS THEY APPLY TO GROUP HOMES AND THEIR RELATIONSHIP TO THE CONTRACT CLAUSE

A. Background of the Conflict Surrounding Restrictive Covenants

Many community living arrangements operate through a series of covenants.¹² Community members' leases or ownership agreements contain limiting language on how the property may be used and who may use it. Restrictive covenants limit the use of the property by acting as private contracts between the parties to increase the value of the land.¹³ Restrictions that appear in subdivisions and condominiums are often as effective as zoning for controlling land use.¹⁴

Typically, covenants in residential subdivisions and condominiums restrict the property to residential use only for single family dwellings and thus, cause discord between the operators of the

12. See Mark Pearlstein, *Slammed Shut: Condo Board Can End Open-Door Policy For Unit's Business Traffic*, CHI. TRIB., July 12, 1998, at 4.

13. See BLACK'S LAW DICTIONARY, supra note 7, at 1315 (defining a restrictive covenant as a "contract between grantor and grantee which restricts grantee's use and occupancy of land; generally, purpose behind restrictive covenants is to maintain or enhance value of lands adjacent to one another by controlling nature and use of surrounding lands").

14. See Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681 (1973) (discussing alternatives to zoning as means to regulate land use such as covenants and nuisance law).

group homes and their surrounding neighbors.¹⁵ For instance, in cases involving group homes for the mentally ill, the operators wish to establish group homes in residential surroundings to enable the residents to reach their full intellectual potential and not be isolated from society in an institutional setting.¹⁶ The neighbors, however, often worry about common disruptions to the neighborhood, including traffic and noise. They also worry about potential lawsuits brought against the homeowners' association if any problems occur.¹⁷ For this reason, litigation often arises when the homes' activities become noticeable outside the boundaries of the home or the neighbors are worried about declining property values.¹⁸

B. Importance of Protecting Contractual Rights of Private Property Owners

Private property owners are in great need of secure contractual relationships today because, in the past, condominium owners could rely on enforcement of zoning laws to protect their rights. Now, "zoning laws are being relaxed to allow for businesses that don't disturb the neighborhood" or at least are held to be tolerable by the overall political community.¹⁹ Restrictive covenants that are found in condominiums' bylaws and in homeowners' agreements

15. See, e.g., *Mains Farm Homeowners Ass'n v. Worthington*, 854 P.2d 1072, 1073 (Wash. 1993) (en banc) ("All lots or tracts in Mains Farm shall be designated as 'Residence Lots,' and shall be used for single family residential purposes only.").

16. See Wanda Ellen Wakefield, *Applicability and Application of Zoning Regulations to Single Residences Employed For Group Living of Mentally Retarded Persons*, Annotation, 32 A.L.R.4TH 1018 (1984) (citing Lippencott, "A Sanctuary for People": *Strategies for Overcoming Restrictions on Community Homes for Retarded Persons*, 31 STAN. L. REV. 767 (1979)).

17. See Mary McAleer Vizard, *Resolving the Business-in-Condo Question*, N.Y. TIMES, Mar. 14, 1993, § 10 (Real Estate), at 5; see also Sam Hankin, *Covenants A Source of Conflict: Community Bylaws Land Many in Court*, WASH. POST, June 11, 1988, at E1. The importance of these covenants is becoming more and more apparent as the number of homeowner and condominium associations increase. The rise of covenants in ownership agreements could be explained by shrinking budgets of local governments which once took care of community facilities. Homeowner's associations were formed, not to enforce covenants, but to care for many of the facilities found in these communities. As a natural progression, however, the homeowners must also maintain their own property, so more restrictions are added to keep property values high.

18. See Roy Bragg, *Texas Judge Won't Allow Home For Mentally Retarded Women*, HOUS. CHRON., Aug. 18, 1993, at A21; Pearlstein, *supra* note 12, at 4; Vizard, *supra* note 17, at 5 ("When there's a complete prohibition against business, it's often only used when there's intrusiveness, and not in other cases."). For a discussion of selective enforcement of restrictive covenants, see *Shaver v. Hunter*, 626 S.W.2d 574, 577-78 (Tex. Ct. App. 1981).

19. Vizard, *supra* note 17, at 5.

provide a method for these neighbors to regulate and enforce the use of their land without relying on the municipality.

There are ways to amend the bylaws and agreements, however, if the members of these sub-communities no longer agree with the limitations.²⁰ Restrictive covenants within these agreements are not a permanent ban on the use of property. If the need for change becomes so great within a community, a majority vote of the owners can alter the agreement.²¹ Therefore, a private property owner's contractual rights will be upheld in order to guarantee that the property will remain within the boundaries of restrictive covenant unless the sub-community finds those boundaries no longer appropriate.

C. Interpreting Terms in Restrictive Covenants May Allow the Courts Never To Consider the Constitutional Question

When litigation does arise, state courts take many factors into account when deciding how restrictive covenants should apply to group homes. One important factor is the interpretation of the terms found within the restrictive covenants. If the courts engage in a broad reading of the terms, such that the group homes do not violate the covenant, they eliminate issues regarding the enforceability of the covenant and constitutional violations. For example, if the court holds that the home's use as a day care meets the terms set forth in the covenant, then there is no need for the operator to raise, or the judge to discuss, whether public policy allows operation of the home.²² This reading also negates the neighbors' ability to raise an impairment of contracts argument.²³ On the other hand, if the terms are read narrowly, the case becomes more complex. The court will have to consider the actual meaning of the terms, balance the rights of all property owners, determine the policy reasons both for and against enforcing the covenants, and discern any constitutional issues. These difficult tasks could dissuade a judge from opening a potential Pandora's box.

20. *See id.* (noting that state law governs the majority vote needed for approval of a change which usually requires two-thirds of the owners).

21. *See id.*

22. *See Terrien v. Zwit*, 605 N.W.2d 681 (Mich. Ct. App. 1999). For further discussion, *see infra* Parts II.C and III.B.

23. *See, e.g., Turner v. United Cerebral Palsy Ass'n*, 772 P.2d 628 (Colo. Ct. App. 1988) (holding that a group home for eight developmentally disabled individuals did not violate the restrictive covenant).

All restrictive covenants, however, are to be read according to their ordinary meaning.²⁴ Furthermore, if the language is unclear, the covenant should be interpreted against the grantor and in favor of the free enjoyment of land.²⁵ Despite these guidelines, state courts have interpreted similar terms in similar covenants in varying ways. For example, "family" has been defined as occupants in a single dwelling who do not need to be related by blood and only must live as a single-family unit.²⁶ Other courts have held that the occupants must be related by blood or marriage as the word "family" is commonly known.²⁷ Texas courts take a different approach and hold that terms that refer to single family dwelling deal only with the architectural structure of the building.²⁸ Thus, the courts' interpretations of the terms in the restrictive covenants can have a crucial impact on the focus of the case.

Similarly, state courts also interpret the "residential use" term found in restrictive covenants in differing manners. Often courts look to the amount of traffic or noise created by the activity to determine whether the residential atmosphere of the neighborhood is maintained.²⁹ Some courts, however, find violations of the "residential use" covenant only when the appearance of the dwelling is substantially altered for a business use.³⁰ Other courts look to whether the business is of any inconvenience to the surrounding property owners to determine a violation of the covenant.³¹ As with the single family term, the residential term in ownership agreements can be interpreted broadly so as not to find conflict with the restrictive covenant, thereby avoiding any issues as to

24. See *Mains Farm*, 854 P.2d at 1074; *Hill v. Community of Damien*, 911 P.2d 861, 866 (N.M. 1996); *Rhodes v. Palmetto Pathway Homes, Inc.*, 400 S.E.2d 484, 485 (S.C. 1991).

25. See *Hill*, 911 P.2d at 866.

26. See *id.* at 863 (interpreting single family requirement to include a group of not more than five people living together).

27. See, e.g., *Adult Group Properties Ltd. v. Imiler*, 505 N.E.2d 459, 467 (Ind. Ct. App. 1987); *Mains Farm*, 954 P.2d at 1074 (holding that a group home for four elderly people that makes a profit is not a single family home).

28. See *Deep E. Tex. Reg'l Mental Health and Mental Retardation Servs. v. Kinnear*, 877 S.W.2d 550, 554 (Tex. Ct. App. 1994) (citing *Collins v. City of El Campo*, 684 S.W.2d 756, 761 (Tex. Ct. App. 1984)).

29. See *Pearlstein*, *supra* note 12, at 4.

30. See *Daniels Gardens, Inc. v. Hilyard*, 49 A.2d 721, 725 (Del. Ch. 1946) (using the test of whether the changes leave "the building in the same general character as a dwelling"); *Jordan v. Orr*, 71 S.E.2d 206, (Ga. Ct. App. 1952) (holding that a conversion of a room in the basement to a second kitchen did not violate the residential purpose of the covenant banning apartment houses).

31. See 20 AM. JUR. 2D *Covenants, Conditions, and Restrictions* § 177 (1995).

whether public policy allows such a covenant to be enforced or whether voiding the covenant would raise constitutional concerns.

D. The Contract Clause

Although other constitutional issues arise during litigation between group homes and homeowners' associations,³² the Contract Clause is particularly relevant because it governs the extent to which a state can interfere with a private contract.³³ The Contract Clause sets the limits for states' inference, and judges often apply it to these cases to determine whether states have exceeded these boundaries. It preserves the right of all private contractual parties.

The Contract Clause of the U.S. Constitution provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts"³⁴ Many state constitutions contain a similar provision and are usually interpreted identically to the federal guarantee.³⁵ The purpose of the Contract Clause is to "protect the expectations of persons who enter into a contract from the danger of subsequent legislation."³⁶ In group home cases, the Contract Clause has been raised in some circumstances by the neighbors of the group homes as a defense when public policy threatens to deny enforcement of the restrictive covenant.³⁷ In effect, the Contract Clause may counter the operator's defense that the covenant is against public policy.

32. See *Barrett v. Dawson*, 71 Cal. Rptr. 2d 899 (Ct. App. 1998) (involving a restrictive covenant as applied to a day care home where the neighbors raised issues of eminent domain); *Hall v. Butte Home Health, Inc.*, 70 Cal. Rptr. 2d 246 (Ct. App. 1997) (concerning a restrictive covenant as applied to group homes for the elderly where the neighboring homeowners claimed violation of due process); *Shaver v. Hunter*, 626 S.W.2d 574, 577-78 (Tex. App. 1981) (regarding enforcement of a restrictive covenant as applied to a group home for the severely handicapped where the homeowners in a subdivision raised equal protection concerns).

33. See *infra* notes 38-42 and accompanying text.

34. U.S. CONST. art. I, §10, cl. 1.

35. See 16B AM. JUR. 2D *Constitutional Law* § 708 (1998). "For purposes of determining whether a law has impaired the obligation of a contract, an appellate court gives the state and federal contract clauses the same effect." *Id.* at n.27 (citing *Caritas Servs., Inc. v. Department of Soc. and Health Servs.*, 869 P.2d 28 (Wash. 1994)).

36. 16B AM. JUR. 2D *Constitutional Law* § 708.

37. See *Clem v. Christole, Inc.*, 582 N.E.2d 780, 784 (Ind. 1991) (holding that retroactive application of Indiana statute voiding restrictive covenants that prohibit occupation of mentally ill persons in a residential facility for any reason is constitutionally prohibited); *Crane Neck Ass'n v. New York City/Long Island County Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984) (stating that the Contract Clause is not violated because the state had a strong interest in the placement of mentally disabled persons in residential surroundings).

Although the text of the Contract Clause is facially absolute, the inherent police power of the states "to safeguard the vital interests of its people" allows state legislatures to abrogate private contracts in certain circumstances.³⁸ In *Energy Reserves*, the U.S. Supreme Court interpreted the Contract Clause to present a three-step test that determines whether the state interference is constitutional.³⁹ First, a court must determine whether there has been any impairment to a private contract, and, if so, the court must then evaluate the degree of the impairment.⁴⁰ When substantial impairment is found, the court must then look to whether there is a significant and legitimate public purpose behind the state regulation at issue.⁴¹ Finally, if the court identifies a significant and legitimate public purpose behind the statute, it must address whether the means by which the state attempts to regulate are appropriately tailored to the identified public purpose.⁴²

The Contract Clause analysis can be applied in two situations when the courts refuse to enforce restrictive covenants applying to group or family day care homes. First, if there is a state statute directly on point that bars enforcement of restrictive covenants as they apply to group homes, courts can uphold the statute and allow the group home to continue to operate in the neighborhood.⁴³ Second, courts may act without a state statute directly on point, refusing enforcement and grounding their act of discretion in the public policy in favor of the operation of the group home.⁴⁴ In either situ-

38. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 410 (1983) (quoting *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 434 (1934)); see also 16B AM. JUR. 2D *Constitutional Law* § 708 ("[T]he federal constitutional protection against the impairment of the obligation of contracts is no greater than other guarantees in the Constitution, and the constitutional prohibition of the passage of laws impairing the obligation of contracts cannot be construed to prohibit the exercise by the state legislature of its other constitutional powers.").

39. *Energy Reserves*, 459 U.S. at 410-12 (analyzing a claim brought by a natural gas supplier seeking determination that it had a right to terminate two contracts because of the public utility's refusal to redetermine price).

40. See *id.*

41. See *id.*

42. See *id.*

43. See *infra* Part II.A.

44. See *infra* Part II.B. Most cases relied upon by this Note do not directly cite to a state statute that precludes enforcement of the covenants but instead rely on judicial impairments of the contract to find a violation of the Contract Clause. There has been much debate on whether judicial impairment of a contract is enough to trigger the protection of the Contract Clause because the text in the clause explicitly speaks to the passage of laws. Some commentators state that the Supreme Court did apply the Contract Clause to judicial actions for a period in U.S. history, but now the Court only interprets the clause to apply to impairment of contracts through legislation. See

ation, however, the private contract is being impaired, and the Contract Clause analysis is relevant.⁴⁵

E. The Fair Housing Act and Its Effect on the Cases Involving Group Homes for the Mentally Ill

Although the state courts have split on the proper way to handle restrictive covenants as they apply to group homes for the mentally ill, the enactment of the FHA has halted much of the questions surrounding these cases. The FHA forbids discrimination in housing and demonstrates a national policy in favor of deinstitutionalizing disabled individuals.⁴⁶ This statute "prohibit[s] special restrictive covenants or other terms or conditions, or denials of service because of an individual's handicap and which . . . exclud[e], for example, congregate living arrangements for persons with handicaps."⁴⁷ The FHA halted the jurisprudence because it is a federal statute that surpasses any provisions within a state's constitution, and the Contract Clause does not apply to the federal government.⁴⁸ While the issue of whether a restrictive covenant can prohibit the operation of group homes for the mentally ill was ren-

Jill E. Fisch, *Retroactivity And Legal Change: An Equilibrium Approach*, 110 HARV. L. REV. 1055, 1075 n.121 (1997); Harold J. Krent, *Should Bouie Be Buoyed?: Judicial Retroactive Lawmaking and the Ex Post Facto Clause*, 3 ROGER WILLIAMS U. L. REV. 35, 51 n.66 (1997).

On the other hand, an argument can be made that judicial impairments of private contracts should also be invalidated by the Contract Clause. Judicial decisions can impair contracts to the same degree as statutes. In addition, when the Constitution was adopted, legislatures were the only lawmaking bodies. Now, modern courts clearly make as well as interpret the law. Finally, the case law tends to favor not extending the Contract Clause to judicial decisions but it is not conclusive. See Henry N. Butler and Larry E. Ribstein, *The Contract Clause and the Corporation*, 55 BROOK. L. REV. 767, 794 n.115 (1989). For a detailed analysis, see Barton H. Thompson Jr., *The History of the Judicial Impairment "Doctrine" and Its Lessons for the Contract Clause*, 44 STAN. L. REV. 1373 (1992).

45. See *infra* Parts II.A-B.

46. 42 U.S.C. § 3604 (1999). The Fair Housing Act does not violate the Contract Clause because the clause is only a limitation on the power of the states. The Contract Clause does not apply to the federal government, and no clause within the Constitution forbids Congress or the federal government from impairing the obligation of contracts so long as they are acting within the scope of their powers. See 16B AM. JUR. 2D *Constitutional Law* § 710 (1998).

47. *United States v. Scott*, 788 F. Supp 1555, 1561 (D. Kan. 1992) (quoting H.R. REP. NO. 100-711, at 23-24 (1988)).

48. See U.S. CONST. art. VI (stating "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States shall be the supreme Law of the Land"); see also *supra* note 46.

dered moot by the FHA, lessons have been learned from the litigation which can be applied to cases involving group family day care.

II. CASES INVOLVING GROUP HOMES AND THE SHIFT TO CASES INVOLVING FAMILY DAY CARE HOMES

A. When State Legislation Bars Enforcement of Restrictive Covenants as They Apply to Group Homes for the Mentally Ill

If a state statute exists that directly prohibits the application of the covenant, courts should apply a Contract Clause analysis when determining the effect of a restrictive covenant on a group home because there is an obvious legislative action. In *Clem v. Christole, Inc.*,⁴⁹ the Indiana Supreme Court decided a case based on a state statute and brought by residential subdivision property owners against developers of group homes for developmentally disabled persons in favor of the subdivision owners.⁵⁰ The court stated that the impairment of the restrictive covenant did not fall within the police powers exception to the Contract Clause,⁵¹ and the Indiana statute that precludes restrictive covenants barring residential use of property as a facility for the developmentally disabled was unconstitutional according to the state's constitution.⁵²

The Indiana Supreme Court recognized a violation of the state Contract Clause in the retroactive application of a statute voiding restrictive covenants that prohibit mentally ill persons from occupying a residential facility for any reason. The court reasoned that this statute did not fall within the necessary police power exception because of the absence of societal necessity.⁵³ The court stated that

49. 582 N.E.2d at 781. The Indiana statute stated:

A restriction, reservation, condition, exception, or covenant in a subdivision plat, deed, or other instrument of, or pertaining to, the transfer, sale, lease, or use of property that would permit the residential use of property . . . as a residential facility for developmentally disabled or mentally ill person: (1) on the ground that the residential facility is a business; (2) on the ground that the persons residing in the residential facility are not related; or (3) for any other reason; is, to the extent of the prohibition, void as against public policy of the state.

Ind.Pub.L. No. 9-1991, § 98.

50. See *Clem*, 582 N.E.2d at 784-85.

51. See *id.* at 784 ("Only those statutes which are necessary for the general public and reasonable under the circumstances will withstand the Contract Clause. It is only this latter necessary police power, rather than the general police power, which provides the exception to the Contract Clause.").

52. See *id.*

53. See *id.*

if "the police power exception is construed too broadly, it would operate to eviscerate the constitutional protection."⁵⁴

The court distinguished between the state's general and its necessary police power required by the Contract Clause to determine that the statute was "not reasonably necessary for the protection of the health, safety, and welfare of the general public."⁵⁵ To support this holding, the court reasoned that the effect of the statute was permanent, irrevocable and retroactive in changing the contractual obligations found in the covenants between the parties.⁵⁶ The court also noted that the purposes of restrictive covenants found in ownership agreements were consistent with the general welfare of the public because they promoted protection, peace, and well-being of all the neighbors within the community.⁵⁷

Although the statute involved in *Crane Neck Ass'n v. New York/Long Island County Services Group*⁵⁸ was not directly on point, the court acknowledged that legislative action caused them to deny enforcement of the covenant.⁵⁹ In *Crane Neck*, a homeowners' association commenced a legal action against agencies that operated leased homes for caring and housing eight severely retarded adults, alleging a violation of the restrictive covenant prohibiting construction or maintenance of other than single-family dwellings.⁶⁰ The neighbors argued that a "court may not refuse to enjoin violation of the restrictive covenant on public policy grounds because it is a private contract which cannot be impaired by the State" based on

54. *Id.* at 783.

55. *Id.* at 784.

56. *See id.*

57. *See id.*

58. 460 N.E.2d 1336 (N.Y. 1984). A Long Island estate, started in 1945, was divided into residential sections, and each deed included an identical covenant restricting buildings to single family dwellings. Agencies leased property within Crane Neck Farm in 1980 to house and care for mentally retarded adults. The property was situated on two wooded acres and contained a six-bedroom home. The adults were in need of constant supervision, so in addition to the resident "house parents," there was a nonresident professional staff of sixteen persons. In a family-type environment and under constant supervision, the mentally retarded adults were taught basic skills and socialization. The adults would be staying at the home for an indeterminate amount of time, but the goal of the program was to allow the adult to reach a certain level of independence so he may leave and be replaced by another in need of supervision. The other Crane Neck Farm property owners sought a judgment enforcing the covenant and enjoining continuation of the lease. *See id.* at 1337-38.

59. *See id.* Section 41.34(f) of New York's Mental Hygiene Law states "[a] community residence established pursuant to this section and family care homes shall be deemed a family unit, for purposes of local laws and ordinances." N.Y. MENTAL HYG. LAW § 41.34 (McKinney 1999).

60. *See Crane Neck*, 460 N.E.2d at 1337-38.

the Constitution.⁶¹ The New York Court of Appeals did not apply a traditional Contract Clause analysis but still rejected this argument:

[T]his court has long recognized that the State's interest in protecting the general good of the public through social welfare legislation is paramount to the interest of parties under private contracts, and the State may impair such contracts by subsequent legislation or regulation so long as it is reasonably necessary to further an important public purpose and the measures taken that impair the contract are reasonable and appropriate to effectuate that purpose.⁶²

The Court concluded that the state's interest and means to promote community residences for the mentally ill were sufficient so as not to allow private contractual rights to override the state policy.⁶³

B. When Courts Decide the Application of Restrictive Covenants to Group Homes Based on Public Policy

Most states, however, do not have a statute directly on point when they are determining what application a restrictive covenant should have on a group home.⁶⁴ Therefore, most courts use their general discretionary powers to decide the cases based on state public policy. Under the public policy doctrine, courts generally have the power to interfere with private contractual rights when the state's interest in protecting the common good is paramount to the rights of the parties under private contract.⁶⁵ When restrictive covenants have been interpreted to prohibit group homes, state courts have considered the "social utility of group homes for mentally disabled persons and determined that restrictive covenants should not be enforced against such homes based on public policy favoring the deinstitutionalization of mentally retarded persons."⁶⁶ If the operator of the group home can prove a longstanding public policy favoring the establishment of group homes for the mentally ill, state courts may choose not to enforce the restrictive covenants

61. *Id.* at 1343.

62. *Id.*

63. *See id.*

64. *See infra* Part II.B.1-2.

65. *See generally* *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 410 (1983); *Crane Neck Ass'n v. New York City/Long Island County Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984).

66. Nora A. Uehlein, *Community Residence For Mentally Disabled Persons As Violation of Restrictive Covenant*, Annotation, 41 A.L.R.4TH 1216 (1985).

because they contravene this policy.⁶⁷ Group home operators and judges use legislative history and state statutes with similar words as those found in the terms in restrictive covenants to prove the existence of a state public policy.⁶⁸

1. *Courts That Have Overridden Restrictive Covenants Based on Public Policy Concerns*

State courts have split, however, on whether public policy concerns can actually preclude enforcement of the restrictive covenant towards group homes for the mentally ill.⁶⁹ In *Crane Neck*, the court agreed with the agencies and held that New York's longstanding public policy (demonstrated through state statutes) for the deinstitutionalization of the mentally ill precluded enforcement of the restrictive covenant that limited use of the residence to single family dwellings.⁷⁰ The court also concluded that the state's interest in "protecting the welfare of mentally and developmentally disabled individuals is clearly an important public purpose, and the means used to select the sites . . . are reasonable and appropriate to effectuate the state's program."⁷¹ Even though there was no statute directly on point, the court effectually enacted legislation that bars the enforcement of these covenants.

Similarly, in 1991, the Supreme Court of South Carolina held, in *Rhodes v. Palmetto Pathway Homes*,⁷² that the restrictive covenant could not be enforced against a group residence for mentally impaired adults.⁷³ The case was brought by Frances Rhodes, an owner of property within a subdivision, seeking a permanent in-

67. See *infra* Part II.B.1.

68. For example, the New York Legislature enacted section 41.34 of the Mental Hygiene Law that reads "A community residence established pursuant to this section and family care homes shall be deemed a family unit for purposes of local laws and ordinances." N.Y. MENTAL HYG. LAW § 41.34 (McKinney 1999). See generally *Westwood Homeowners Ass'n v. Tenhoff*, 745 P.2d 976, 978 n.2 (Ariz. Ct. App. 1987) (listing 30 state statutes that have been adopted in accordance with the trend towards deinstitutionalizing the mentally ill).

69. Compare *Crane Neck Ass'n v. New York City/Long Island County Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984) (holding that New York's longstanding public policy in favor of group homes for the mentally ill outweighed the interest of private contractual rights), with *Clem v. Christole, Inc.*, 582 N.E.2d 780, 784 (Ind. 1991) (upholding restrictive covenant against group home for mentally ill since "statutory impairment of existing restrictive covenants does not fall within the necessary police power exception to the Contract Clause because of the absence of societal necessity").

70. See *Crane Neck*, 460 N.E.2d at 1343.

71. *Id.*

72. 400 S.E.2d 484 (S.C. 1991).

73. *Id.* at 486.

junction against Palmetto Pathway Homes, a non-profit corporation, alleging that the use of the property as a home for unrelated mentally impaired adults was prohibited by the restrictive covenants.⁷⁴ The court stated that to “prohibit location” of such a home within their community would be “contrary to public policy as enunciated by both state and federal legislation.”⁷⁵ In its opinion, the court looked to the FHA, the purpose of the covenant, and the public policy in favor of group homes to support their decision.⁷⁶

Several appellate level courts also have denied enforcement of restrictive covenants against group homes for the mentally ill because of the state’s public policy. In *Deep East Texas Regional Mental Health and Mental Retardation Services v. Kinnear*,⁷⁷ the Texas Court of Appeals for the Ninth District decided a case brought by Joe Kinnear and other unnamed plaintiffs, all property owners within a subdivision, against Deep East Texas Regional Mental Health and Mental Retardation Services (“DET”).⁷⁸ The plaintiffs wanted to prohibit DET, under the terms of a restrictive covenant, from constructing a community home in the subdivision for six mentally impaired females.⁷⁹ The court held that Texas has a “valid and legitimate State governmental interest in protecting and promoting the public health and welfare of the mentally ill and

74. See *id.* at 485. The court quoted the relevant section in the restrictive covenant:

The property hereby conveyed shall not be used otherwise than for private residence purposes, nor shall more than one residence, with the necessary outbuildings be erected on any one lot, nor shall any apartment house or tenement house be erected thereon; nor shall any one lot be subdivided or its boundary lines changed from the location as shown on said map without in any one of the cases above enumerated the written consent of the grantor endorsed on the deed of conveyance thereof.

Id.

75. *Id.* at 486.

76. See *id.* at 485-86; see also discussion *infra* Parts II.B-C.

77. 877 S.W.2d 550 (Tex. App. 1994).

78. See *id.* at 553.

79. See *id.* The supervision of this home was to be on a twenty-four hour, seven-day-a-week basis. The restrictive covenant read:

All lots shall be known and described as lots for residential purposes only. Only one one-family residence may be erected, altered, placed or be permitted to remain on any lot. Said lots shall not be used for business purposes or [sic] any kind nor any commercial, manufacturing or apartment house purposes.

Id. at 554. It also stated that “[n]o noxious or offensive activity shall be carried on upon any lot, nor shall anything be done thereon which may be or become an annoyance or nuisance to the neighborhood.” *Id.*

the mentally retarded”⁸⁰ The court also stated that the “restrictive covenants . . . must yield to the exercise of the State’s legitimate police power.”⁸¹

In *Westwood Homeowners Ass’n v. Tenhoff*,⁸² the Arizona Court of Appeals decided a case brought by a nonprofit homeowner’s association against a residential facility for the developmentally disabled seeking declaratory and injunctive relief based on a violation of the restrictive covenants within a subdivision agreement.⁸³ The court held that the restrictive covenant was contrary to the public policy of the state codified in the Arizona Developmental Disabilities Act.⁸⁴ The court extended the public policy found in the statute beyond zoning to include private covenants that precluded residential facilities in residential neighborhoods.⁸⁵

Finally, a Michigan appellate court held in *Craig v. Bossenbery*⁸⁶ that a restrictive covenant was not enforceable because of strong public policy supporting residential surroundings for the mentally ill.⁸⁷ The court traced the state’s support of the mentally ill from the 1908 Constitution to the present day.⁸⁸ Because of this sup-

80. *Id.* at 560.

81. *Id.*

82. 745 P.2d 976 (Ariz. Ct. App. 1987).

83. *See id.* at 977. The residential facility housed fewer than six developmentally disabled children and young adults and included an employee who provided them with parental care. The house was financed by Mesa Association for Retarded Citizens. The restrictive covenant declared in its relevant portions:

No livestock or poultry shall be kept on any of said lots and no store, office, or other place of business of any kind and no hospital, sanitarium, or other place for the care or treatment of the sick or disabled, physically or mentally, nor any theater, saloon or other place of entertainment shall ever be erected or permitted upon any of said lots, or any part thereof, and no business of any kind or character whatsoever shall be conducted in or from any residence on said lots.

Id. at 977-78.

84. *See id.* at 984. The Act states that residential facilities that care for “six or fewer persons shall be considered a residential use of the property for all local zoning ordinances.” ARIZ. REV. STAT. § 36-582(a) (1978).

85. *See Westwood Homeowners*, 745 P.2d at 984.

86. 351 N.W.2d 596 (Mich. Ct. App. 1984).

87. *See id.* at 601.

The strong public policy supporting group homes overcomes the public policy which favors the right of property owners to create restrictive covenants. We cannot consider the property owners’ apparent motives in drafting or retaining a covenant lest we encourage indirect methods to exclude the handicapped where blatant, direct methods would clearly fail.

Id.

88. *See id.* at 599. “Institutions for the benefit of those inhabitants who are deaf, dumb, blind, feeble-minded or insane shall always be fostered or supported.” MICH. CONST. OF 1908, art. II, § 15 (1908).

port, the court decided that the "worthy goal" of deinstitutionalization should prevail over the right to contract.⁸⁹

2. *Courts That Have Rejected Public Policy Concerns To Override Covenants*

Not all states, however, accept public policy in favor of group homes for the mentally ill over public policy supporting contractual rights of property owners. In *Omega Corp. of Chesterfield v. Malloy*,⁹⁰ owners of lots in a subdivision filed suit to restrain Omega Corp. from using its lots within the subdivision as group homes for the mentally ill.⁹¹ The Virginia Supreme Court held that restrictive covenants affecting group homes for the mentally ill cannot be overridden due to the state's public policy in favor of such homes set forth in zoning ordinances.⁹² The court based its conclusion on the private contractual rights in the restrictive covenants and stated that "Chesterfield's zoning ordinance cannot relieve the lots in question from the restrictive covenants to which they are subject."⁹³

Additionally, a Court of Appeals in Texas held that a shelter for severely handicapped adults violated the restrictive covenant found in a subdivision's agreement.⁹⁴ The court stated that selective enforcement of the restrictive covenant would not pass constitutional muster and that the covenant was not unreasonable nor against public policy.⁹⁵

In *Mains Farm Homeowners Ass'n v. Worthington*,⁹⁶ the Supreme Court of Washington did not make a definitive ruling re-

89. See *Craig*, 351 N.W.2d at 599.

90. 319 S.E.2d 728 (Va. 1984).

91. See *id.*

92. See *id.* at 729. Omega Corp. of Chesterfield is a nonprofit organization that owns one lot in each of two subdivisions subject to restrictive covenants. Omega Corp. intended to build a dwelling on each lot "to provide mentally retarded adults with normal residential housing in a community setting including the activities and life-style incident to such a setting." *Id.* (internal quotes omitted). Both subdivisions, however, contain covenants that limit the property to residential purposes and single-family dwellings. See *id.* "No Lot shall be used except for residential purposes. No building shall be erected, altered, placed, or permitted to remain on any lot other than one detached single-family dwelling not to exceed two stories in height." *Id.*

93. *Id.* at 732 (citing *Ault v. Shipley*, 52 S.E.2d 56, 58 (Va. 1949)).

94. *Shaver v. Hunter*, 626 S.W.2d 57 (Tex. Ct. App. 1981).

95. See *id.* at 578-79.

96. 854 P.2d 1072 (Wash. 1993) (en banc). A homeowners association brought an action alleging that an adult family home violated a protective covenant that the property would be used for single-family residential purposes only. The defendant occupied the residence with four adults who paid her yearly for 24-hour care, seven-days-a-week. See *id.*

garding the effect of public policy and covenants. Instead, the court reasoned that the interpretation of a certain restrictive covenant should depend on the facts of each case.⁹⁷ The court did state that all of the "cases relied upon by the defendant do not support the bald assertion that public policy invalidates an existing protective covenant."⁹⁸ The court continued by noting "[c]ourts should not equate the concern of zoning laws with the concerns of restrictive covenants."⁹⁹

C. Prior Treatment of Restrictive Covenants as They Apply to Group Family Day Care Homes

State courts also have been trying to find an effective way to deal with restrictive covenants and group day care homes. Deinstitutionalizing the mentally ill and providing safe child care in a residential setting are both issues that have long been supported by states' public policies. Family day care in the home is one of the largest cottage industries in the country.¹⁰⁰ It is the primary source of child care for children under three and is most important for families where both parents are working and cannot meet the strict hours day care centers keep.¹⁰¹ Child day care homes, however, also meet opposition from neighboring homeowners based on restrictive covenants that require single family dwellings for residential use only.¹⁰² To make matters more complicated, child day care homes are not protected by the FHA as are many group homes for the mentally ill and other homes caring for people with disabilities.¹⁰³

In *Terrien v. Zwit*,¹⁰⁴ a Michigan Court of Appeals held that the operation of a group family day care did not violate a restrictive covenant in a subdivision agreement that prohibited all commercial

97. See *id.* at 1080.

98. *Id.* The defendant cited such cases as *Crane Neck Ass'n v. New York City/Long Island City Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984), *Westwood Homeowners Ass'n v. Tenhoff*, 745 P.2d 976 (Ariz. Ct. App. 1987), *Barrett v. Lipscomb*, 240 Cal. Rptr. 336 (Ct. App. 1987), and *Turner v. United Cerebral Palsy Ass'n*, 772 P.2d 628 (Colo. Ct. App. 1988).

99. *Id.* (quoting Guernsey, *The Mentally Retarded and Private Restrictive Covenants*, 25 WM. & MARY L. REV. 421, 454 (1985)).

100. See Judy Mann, *Day Care*, WASH. POST, Mar. 14, 1984, at C1.

101. See *id.*

102. See *Barrett v. Dawson*, 71 Cal. Rptr. 2d 899 (Ct. App. 1998); see also *Quinones v. Board of Managers*, 673 N.Y.S.2d 450 (App. Div. 1998).

103. See *Hill v. Community of Damien*, 911 P.2d 861 (N.M. 1996).

104. 605 N.W.2d 681 (Mich. Ct. App. 1999).

or business uses of the property.¹⁰⁵ The plaintiffs, who were the other owners of the lots in the subdivision, argued that because the day care charged a fee, it qualified as a business and therefore violated the covenant.¹⁰⁶ The operator contended that compensation for services is only one factor to be considered when determining whether an activity violates a covenant prohibiting commercial use, and the court agreed.¹⁰⁷ The court did not acknowledge a Contract Clause concern and relied only on the interpretation of the covenant and public policy in favor of home day care to support its holding.¹⁰⁸

In *Barrett v. Dawson*,¹⁰⁹ a California Court of Appeals ruled a restrictive covenant preventing a family day care center in a neighborhood was void based on a state statute barring such covenants.¹¹⁰ The neighbors argued that denying enforcement of the restrictive covenant violated the state and federal Contract Clause.¹¹¹ The court, using the three-step analysis,¹¹² acknowledged the substantial impairment of the neighbors' contract by the statute but also recognized "a significant and legitimate public purpose behind the state regulation which voids the enforcement of the contract right."¹¹³ Lastly, the court stated that the statute, because it was tailored to the promotion of home day care and not

105. *See id.* at 685.

106. *See id.* at 684. The subdivision agreement contained three relevant covenants:

1. No part of any of the premises above described may or shall be used for other than private residential purposes. . . .

3. No lot shall be used except for residential purposes. . . .

14. No part of parcel of the above-describes premises shall be used for any commercial, industrial, or business enterprises nor the storing of any equipment used in any commercial or industrial enterprise.

Id. at 682.

107. *See id.* (stating that a court can also look to the nature of the activities on the property).

108. *See id.*

109. 71 Cal. Rptr. 2d 899 (Ct. App. 1998). Neighbors filed suit to enforce the restrictive covenant to close down a family day care home operating in their neighborhood. The restrictive covenant prohibited commercial and business activity on the property. *See id.* at 900.

110. *See id.* The statute states that a "restriction or prohibition entered into, whether by way of covenant, condition upon use or occupancy, or upon transfer of title to real property, which restricts or prohibits directly, or indirectly limits, the acquisition, use, or occupancy of such property for a family day care home for children is void." *See* CAL. HEALTH AND SAFETY CODE § 1597.40(c) (West 2000).

111. *See Barrett*, 71 Cal. Rptr. 2d at 902-03.

112. *See supra* notes 38-42 and accompanying text.

113. *Barrett*, 71 Cal. Rptr. 2d at 903 (quotation marks omitted) (stating that "adequate and local day care for working parents is probably about as broad a public purpose as any that might be imagined in the regulatory universe").

commercial kindergarten, satisfied the final step requiring character appropriate means.¹¹⁴

Where there is not a specific statute that voids restrictive covenants prohibiting group family day care homes, an operator of such a group home can argue that pure public policy within the state requires denying enforcement of the covenant. A New York court held in 1998 that enforcement of a restrictive covenant, as applied to a group family day care home, violated public policy.¹¹⁵ The court, however, did not use the three-step Contract Clause analysis, but instead relied only on the state's public policy to support its decision, which it considered analogous to *Crane Neck*.¹¹⁶ In addition, the court cited only to a social services law addressed to local municipalities and to two instances of support within the legislature for home day care to uphold their decision that private parties cannot hinder the operation of a day care through a covenant.¹¹⁷

III. APPLYING THE CONTRACT CLAUSE TO RESTRICTIVE COVENANTS AND GROUP HOMES FOR CHILD DAY CARE: A NECESSARY ANALYSIS

A. The Contract Clause Analysis: Restoring the Private Contractual Rights of Individuals

The constitutional issue of impairment of private contracts by the state must be addressed when covenants are abrogated either by legislative or judicial action. Both the police power doctrine used by legislatures and the public policy doctrine used by the courts find their roots in the Contract Clause. If either doctrine is invoked to void a restrictive covenant, the three-step analysis created by the Supreme Court in *Energy Reserves Group v. Kansas*

114. *See id.*

115. *See Quinones v. Board of Managers*, 673 N.Y.S.2d 450, 454 (App. Div. 1998). *See supra* note 44 for a discussion on the application of the Contract Clause to judicial impairment of contracts.

116. *See Quinones*, 673 N.Y.S.2d at 452-54.

117. *See id.* The New York State law provides that no local municipality may: [A]dopt or enact any law, ordinance, rule or regulation which would impose, mandate or otherwise enforce standards for sanitation, health, fire safety or building construction on a one or two family dwellings or multiple dwelling used to provide group family day care . . . than would be applicable were such child day care not provided on the premises [and that] no local government may prohibit use of a single family dwelling . . . for . . . group family day care where a permit for such use has been issued in accordance with regulations issued pursuant to this section.

Id. at 452 (quoting N.Y. SOC. SERV. LAW § 390(12) (Consol. 1999)).

*Power & Light Co.*¹¹⁸ should be applied.¹¹⁹ When courts use the public policy doctrine to override restrictive covenants, they are, in fact, wrongly presupposing that there is no potential constitutional violation of the Contract Clause.

To allow an impairment of a contract by the state judiciary, but not by the state legislature, is differentiating merely between which branch of the state government impairs the contractual relationship and not whether such an impairment is constitutional. *Crane Neck Ass'n v. New York/Long Island County Services Group*¹²⁰ exemplifies that judicial impairment, based on the public policy doctrine, affects a contract just as substantially as state legislative action.¹²¹ The court in *Crane Neck* applied an analysis that is similar to the *Energy Reserves* test even in the absence of a statute directly on point.

Furthermore, if judicial action is not sufficient to trigger the Contract Clause analysis, the state legislatures are able to shirk their duty of considering the effects of their legislation by merely encouraging a policy in favor of home day care. When the state legislature does not directly abrogate restrictive covenants prohibiting family day care, it is passing the obligation onto the judiciary to determine whether the abrogation is constitutional. If the judiciary is not required to decide whether the abrogation violates the Contract Clause, then the state can bypass the Constitution and impair the rights of privately contracting parties.

The use of the *Energy Reserves* analysis will allow each state intervention of a private contractual relationship to be fully examined. It also will ensure that the private property owners' interests are being compared to those of the state's in supporting operation of child day care homes and not being compared to the state's interest in operating group homes for the mentally ill.

The Contract Clause analysis should thus be used as a method to determine whether state action is appropriate, because if the state courts look only to the existence of public policy, the courts will have too much discretionary power. Restrictive covenants could be overridden when only a low level of policy exists, or simply voided when a less extreme result could have been possible. For example, the courts could tailor their decision to deny enforcement of a restrictive covenant based on the number of children in the

118. 459 U.S. 400 (1983).

119. See *supra* Part I.D.

120. 460 N.E.2d 1336 (N.Y. 1984).

121. See *supra* Part II.B.

day care or based on the proximity of the day care to other neighbors. The courts also could decide to enforce the restrictive covenants prospectively but deny abrogation of the covenants retrospectively. Even if courts would reach the same result without applying the *Energy Reserves* test, the neighbors would have been assured that through this analysis, their constitutional rights would not have been violated or only nominally considered.¹²²

Private property owners cannot always rely on zoning laws or changes in bylaws within their community groups to uphold their rights.¹²³ Entering into an agreement that contains a restrictive covenant that prohibits commercial use of the property is a voluntary decision because not all land is governed by these covenants.¹²⁴ The operators of day care homes choose property that is close to other property, that is desirable, and that carries limitations on its use. Presumably, the market price of the land reflected these qualities. If the restrictive covenants are unfair or depreciate the value of the land, then a majority of the owners can revise them. Additionally, the operators of the family day care homes may be benefiting from the restrictive covenants. The day care may be more marketable because of the preferred residential setting. The day care is profiting from the prohibition on the property owners by disregarding the covenant. Therefore, a private property owner's contractual rights need to be upheld in order to disable the freerider and to guarantee that the property will remain within the boundaries of the restrictive covenant and still be efficient. The best way to secure this right is through a fair method of analysis within the courts using the Contract Clause.

B. Distinguishing Litigation Between Group Homes for the Mentally Ill and Group Homes for Child Day Care

Although courts do not often use the Contract Clause to decide cases for the mentally ill, when they employ this method of analysis, each party receives a full consideration of its interests. The Contract Clause analysis should be extended to cases involving group homes for child day care to ensure the effective examination

122. See Vizard, *supra* note 17, at 5 (arguing that private property owners need contractual relationships because, in the past, condominium owners could rely on enforcement of zoning laws to protect their rights, but now zoning laws are being relaxed to allow for businesses that do not disturb the neighborhood).

123. See *supra* notes 19-21 and accompanying text.

124. Most property in small towns is unrestricted. Therefore, property that is not subjected to covenants limiting business use can still be used for home day care without any complaints from neighbors. See Bragg, *supra* note 18, at A21.

of all the parties' rights. The cases on group homes for the mentally ill, however, do not provide strong precedent because the cases were quite inconsistent, and the doctrine was never fully developed due to the passing of the FHA.¹²⁵ Therefore, the doctrine on group homes for the mentally ill was preempted by the FHA before it was settled among the states, and, although it may provide a starting point for analysis, it is not an effective comparison for group family day care homes.

Even if the Contract Clause analysis was being utilized in all cases involving family day care, states must concede that their interest is different with respect to group homes for the mentally ill and for child day care. For instance, residents of group homes for the mentally ill live in those homes full time, while children in day care have independent homes separate from the day care residence. A state's interest in promoting the deinstitutionalization of the mentally ill is greater because the group homes provide a permanent residential atmosphere. The family day care homes, however, only provide a day time residential atmosphere. The neighbors of permanent residences experience greater effects, such as noise, that could be used as a justification for regulation of the homes for the mentally ill by the state.

In addition, the liability issues differ between family day care homes and group homes for the mentally ill. Group homes for the mentally ill could be liable for the actions of their residents because the homes have assumed a special relationship with the residents.¹²⁶ This increased liability could provide greater support for the state's interest in the regulation towards group homes for the mentally ill. Because of these reasons, a court should not abrogate the restrictive covenant as it applies to a family day care home because the court had previously denied enforcement of a covenant as it applied to a home for the mentally ill. An undeveloped doctrine should not be extended to cases where different interests exist without the necessary constitutional analysis.

125. *See supra* Part I.E

126. "There is no duty . . . to control the conduct of a third person as to prevent him from causing physical harm to another unless (a) a special relationship exists between the actor and the third person which imposes a duty upon the actor to control the third person's conduct." RESTATEMENT (SECOND) OF TORTS § 315(a) (1965).

C. Why *Quinones*, *Barrett* and *Terrien* Ineffectively Analyze Restrictive Covenants As They Apply to Family Day Care Homes

*Quinones v. Board of Managers*¹²⁷ is an insufficient determination of whether a court should deny enforcement of a restrictive covenant as it applies to a group home for family day care because the court fails to apply the *Energy Reserves* test and fails to show significant public policy that is unique to family day care. The New York Social Services Law to which the court refers is particularly addressed to local governments not imposing regulations or limitations on a dwelling merely because the dwelling is used for home day care.¹²⁸ Restrictive covenants found in a condominium's by-laws, however, apply to every member in the condominium. No extra limitations are placed on the day care operators as compared to the other members and, therefore, it should not violate the social services law.

In addition, the court fails to take into account the differences between this case and *Crane Neck*.¹²⁹ Specifically, in *Quinones*, the parties live in a condominium. *Crane Neck* involved separate single-family homes. Residents in condominiums should have more control over the use of the units because of the close proximity to the other residents. If the court had used the *Energy Reserves* test, the court may have required the operator to make more of a showing that the covenant should be abrogated.

*Terrien v. Zwi*¹³⁰ does not mention the Contract Clause and interprets the covenant broadly, preventing a day care home from qualifying as a business despite compensation for the operators.¹³¹ Although the outcome may be the same whether the court chooses to interpret the terms in the covenant narrowly or broadly, the courts should be honest about the basis for their decisions. It is perfectly legitimate to read terms in a covenant broadly when the precedent in certain states support liberal interpretations of covenants. A court should not, however, avoid a constitutional issue merely by its arbitrary interpretation.

While the court applies the *Energy Reserves* test in *Barrett v. Dawson*,¹³² the court impairs the covenant with little analysis. The

127. 673 N.Y.S.2d 450 (App. Div. 1998).

128. See *supra* note 118.

129. See *supra* Part III.B for further discussion.

130. 605 N.W.2d 681 (Mich. Ct. App. 1999).

131. See *supra* Part I.C.

132. 71 Cal. Rptr. 2d 899 (Ct. App. 1998).

court states that "local day care is as broad a public purpose as any that might be imagined in the regulatory universe."¹³³ This statement demonstrates the ease at which a court can find a significant public purpose of the state. The effectiveness of the *Energy Reserves* test is greatly diminished when judges can validate their abrogation of covenants based only on their opinions regarding important state objectives.

D. Illustration of Applying the Energy Reserves Test to a Case Involving a Group Family Day Care Home

Quinones exemplifies a court not acknowledging the Contract Clause and simply bootstrapping the issues regarding group homes for child day care to those involving the mentally ill.¹³⁴ For example, if the court had applied the *Energy Reserves* test, it may have reached a different result. First, a substantial impairment of the contract, namely the restrictive covenant, definitely existed here because the covenant could not be enforced against the operators of the day care home. Because the impairment of the contract here was severe, the state action must be subjected to an increased level of scrutiny.¹³⁵ Second, because the state action constituted substantial impairment of the contractual relationship, the state must then identify a significant and legitimate public purpose, such as remedying a broad and general social economic problem, to justify the impairment.¹³⁶ Here, the state has an interest in providing quality day care to children within a residential setting. This interest certainly qualifies as a broad problem that affects many citizens.

Finally, the court must determine whether the change in the rights of the contracting parties is of a character appropriate to the public purpose that justifies the state action banning the restrictive covenant.¹³⁷ When state legislation adjusts the rights of the contracting parties, the courts must properly defer to the legislature as the arbiter of the necessity and reasonableness of the regulation. When no state statute exists and the judiciary is taking the action, such as in *Quinones*, the court's conduct must be necessary and reasonable. According to at least one state supreme court, completely barring enforcement of the restrictive covenant is not rea-

133. *Id.* at 903.

134. *See id.*

135. *See Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983) (citing to *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978)).

136. *See id.* at 411-12.

137. *See supra* Part I.D.

sonably necessary for the welfare of the general public.¹³⁸ Denying the enforcement of a restrictive covenant is a permanent adjustment of the contractual relationship between the parties.¹³⁹ In addition, these types of covenants have not traditionally been regulated or altered by the state.¹⁴⁰

The court could have taken less extreme measures. Specifically, the court could have prospectively banned restrictive covenants that prohibited family day care. It is likely that a different result could have been reached by the court had it done the suggested analysis. The *Quinones* court only considered one social services law and a few legislative statements to support New York's interest in residential child day care. This cited information does show that the state had an interest in this service,¹⁴¹ but it is not identified as a "longstanding public policy."¹⁴² Moreover, it is also not clear from this information that these restrictive covenants "pose the same deterrent to the effective implementation of the state policy."¹⁴³

CONCLUSION

In the litigation surrounding restrictive covenants and group homes for child day care, the Contract Clause analysis, specifically the one found in *Energy Reserves*, should be adopted by courts. The analysis will ensure that these cases are not being under-analyzed or that the public policy in favor of group homes for child day care will not merely be "piggy-backed" on the policy supporting group homes for the mentally ill. By requiring that the state action, either legislatively or judicially, be necessary to a legitimate governmental purpose, private contractual relationships will still be respected. It is important to note that just because these restrictive

138. See *Clem v. Christole, Inc.*, 582 N.E.2d 780, 784 (Ind. 1991).

139. See *id.*

140. See *id.* "In determining the extent of the impairment, we are also to consider whether the industry the complaining party has entered has been regulated in the past." *Energy Reserves*, 459 U.S. at 411 (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978)).

141. See *Condominium Board May Not Restrict Right to Use Unit As A Group Home For Family Day Care*, 12 No. 9 N.Y. REAL EST. REP. 2, July 1998 (arguing that the social services law only extends to municipalities and does not mention private restrictions). "[A]rguably, residents of a condominium ought to have more control over how the units are occupied because of the greater interdependence among units than is common among single-family houses." *Id.*

142. *Crane Neck Ass'n v. New York City/Long Island Servs. Group*, 460 N.E.2d 1336 (N.Y. 1984).

143. *Id.*

covenants are upheld, it does not prevent family day care homes for children. These rulings simply preserve the contractual relationship between the neighbors.¹⁴⁴

144. *See also* Bragg, *supra* note 18, at A21 (noting that not all land is subject to limitations on commercial use).

