

EASEMENTS AND RESTRICTIVE COVENANTS IN COMMERCIAL AND MIXED USE DEVELOPMENT

Easements, covenant and restrictions are very flexible tools which are frequently used in the development and operation of many kinds of commercial real estate projects. They may be used separately or together, in simple documents or in documents containing many (too often too many) pages. The documents may be called any number of names, but the more common forms are frequently called “Master Restrictions” or “Reciprocal Easement Agreements” or “Operating and Easement Agreements” or “Easements, Covenants and Restrictions”. This article will address some areas of Texas law concerning the use of easements, covenants and restrictions in commercial and mixed use commercial developments (for example office and hotel, or office and retail) and touch on the law relevant to the operation of an owner’s association which may be used in the administration of the development. This effort will avoid the subject of restrictive covenants in residential situations and the operation of residential homeowners’ associations. Particularly with respect to residential homeowners’ associations, the rules governing operation may be substantially different from those governing an association of owners of commercial properties.

I. REVIEW OF THE BASICS

A. Easements. Easements are interests in fee in land, and as such must meet the requirements of the Statute of Frauds (Texas Business and Commerce Code Sec. 26.01). The requirements of the statute are commonly cited as a writing, containing words of reservation or grant, describing the easement created, describing the real property encumbered by the easement and signed by the grantor. Of course, in the context of a commercial real estate transaction, the document should be acknowledged so as to be recordable and should be recorded.

B. Restrictive Covenants. Restrictive covenants are sometimes said to be “negative easements” although that is only one type of restrictive covenant.

1. **Negative Easements.** An easement allows the beneficiary to use the property of another party, while a “negative easement” prohibits or limits a party in the operation of his or her own property. The formalities of creation of a negative easement are the same as the creation of other easements, and the courts require in addition that they be for a lawful purpose, be reasonable and not violate a public policy. *Wald v. West MacGregor Protective Association*, 332 S. W. 2d 338 (Tex. Civ. App. –Houston 1960, writ ref’d n. r. e.).
2. **Covenants.** Covenants are obligations to do some act. They may be personal covenants binding on the parties to the agreement only, or they may

be covenants running with the land, and binding on all future owners for the term of the covenant. Covenants running with the land are sometimes referred to as “equitable servitudes”. See, e.g., *Clear Lake City Water Authority v. Clear Lake Utilities Company*, 549 S. W. 2d 385 (Tex. 1977).

- a. **Personal Covenants.** A personal covenant is simply a contract that has something ancillary to do with real property. In the *Clear Lake Water Authority* case, for example, the Texas Supreme Court held that an agreement between predecessors in ownership about the source of water supply to an apartment complex was collateral to the use of the land, and would not be enforced between successors who had not agreed to or assumed the obligation.
- b. **Running with the Land.** If a covenant sufficiently “touches and concerns” the land, specifically binds the parties and their successors, is intended to run with the land and when the successor has notice of it (constructively through recording or actual notice), then the covenant is said to “run with the land” and is enforced against the successor owners in accordance with its terms. See *Inwood North Homeowners’ Association, Inc. v. Harris*, 736 S. W. 2d 632 (Tex. 1987). A covenant to pay a maintenance assessment was held to run with the land in that case.

C. Applicable Areas of Law.

1. **Common Law and Statutory Law.** Most of the law in Texas concerning easements, covenant and restrictions is common law. The cases which deal with commercial restrictions and covenants are not numerous, and the Supreme Court visits this subject rarely. Most of the cases deal with enforcement or interpretation of residential covenants and restrictions, usually disputes about what is residential use of property, or disputes about the enforcement of obligations to pay for the upkeep of common areas. The past few years have seen the enactment of a few statutes which apply to easements, covenants and restrictions, but most of those statutes are restricted in their application to residential property. They are scattered through the books, although there is a concentration in the Property Code. See Section 5.025 which prohibits enforcement of a covenant requiring wood shingle roofs on residences, and Section 5.026 which voids restrictions in the sale or lease of property on the basis of race, color, religion or national origin. Also in the Property Code is Title 11 containing Sections 201 through 206. Only Sections 202 and 203 seem to apply to commercial property.
2. **Property and Contract Law.** The creation of easements, both negative and ordinary, and covenants which run with the land, is governed by principles of real property law. The realm of possible subject matter of easements,

restrictions and covenants properly created is rooted in the law of contracts and the rule seems to be that the Courts today will allow the parties to create and enforce easements, covenants and restrictions in a commercial context in almost any shape the parties can conceive. The application and interpretation of easements, covenants and restrictions, is very much based in contract law, applying the same maxims of interpretation that are used with contracts in general.

II. Frequent Uses of Reciprocal Agreements and Covenants.

The uses of easements, covenants and restrictions is limited only by the imagination of the draftsman. The following is a list of the provisions that I have encountered most frequently in my practice.

- A. Access.** Access is probably the second most frequently granted easement, after utility easements. In addition, access is frequently the subject of restrictive covenants concerning its use. The State Bar has included a form of Easement for Reciprocal Access in the new Forms Manual. A copy of the draft of that form is attached.

1. Joint Entrance/Curb Cut. This is the most simple form of access easement, allowing two adjacent properties, both with frontage on a street, to share a driveway to that street. It is particularly common where local regulations limit the spacing of entrances onto streets so as to reduce traffic delay from people turning into driveways. Even this simple easement should be elaborated with some covenants in many cases. Who is to maintain the joint area? Is there to be a sharing of maintenance costs? Is it to be used for truck access for loading or only for customer cars? Are there limits on the hours it can be used? These subjects, if appropriate to the situation, are properly handled by covenants and restrictions in an easement document.

2. Driveways. This is an extension of the joint curb cut idea. It creates an easement that can permit traffic to cross one tract to get to another. The same issues raised in the discussion of the joint curb cut may need to be addressed. In addition, there may be issues of striping and traffic control signs.

- B. Parking.** Parking is not the same right as access. My clients, at least, have sometimes jumped to the conclusion that the right to access means the right to park, and that is not true. If there is to be reciprocal parking granted, there are a host of issues to be dealt with. What kind of vehicles and for how long? Is there to be a restriction on hours so that repairs and sweeping can be done? Is either party of both to be held to an obligation to maintain sufficient parking on his or her tract so that one tract does not bear an unfair burden (so called “parking ratio

clauses”). Sometimes these agreements are used to allow two users to have collectively less parking than they would be required to have if considered separately. For example, a movie theater may use the parking of an adjacent office building in the evening and thereby comply with local code requirements, while the office building can use the theater parking during the day to supply its needs.

- C. **Utilities.** Probably the most often used of the easement grants, this type of easement also requires consideration of the use of covenants and restrictions. For example, is the grant to be use of underground only or of the surface? Is the party placing lines in the easement required to patch the surface after digging it up? Must repair and replacement work be done at night so as not to disturb the utility supply to a store or office building during its operating hours, or done at off-peak season so as not to disrupt the Christmas shopping frenzy? Can the burdened party relocate the easement so as to provide the same service but to allow it to expand a store or office on its site?
- D. **Signs.** If multiple owners are to share a sign pylon for their tenants, or if one party has only a small frontage and needs a location on the adjacent tract for a sign indicating the driveway location, an easement for a sign and sign structure may be created. Again, the simple notion of a location for a sign may have complexities. How high and how big can the sign be? Can it twirl, flash, send out firecrackers or otherwise attract attention. If not limited by restrictions, the beneficiary of the sign easement may have such implied rights. Is the sign to be illuminated at night? If so, by internal or external lights? Who pays for the electricity to operate the lights? Is there an implied right to run an electric line to the sign if an easement for that purpose is not expressly provided for? I think probably not.
- E. **Building Size, Location, Height and Appearance.** These subjects are commonly addressed in both planned development projects and in simple two party reciprocal agreements. These restrictive covenants are the prototype for “negative easements” because they limit use of one’s own property. The most complex issues deal with architectural compatibility, because that is an artistic matter which can be the subject of great differences in taste. The cases hold that a party having the power of architectural approval (or discretionary building location, height or the like) has broad latitude in the decision so long as the decision is within the realm of the reasonable and is made in good faith.
- F. **Repair and Maintenance.** In both planned developments and two party situations, it is likely that a standard of repair and maintenance will be imposed on the properties to prevent the neighborhood eyesore. Describing the standards will often be difficult. Grass will need to be mowed, but how often? Parking lots will need to be swept, but when? Enforcement is problematical. Self help remedies are legal (so long as no breach of the peace occurs), but may not be

practical. Specific performance may be available, but courts are likely to order repairs in only the most extreme circumstances.

G. Use Restrictions. Covenants and restrictions are frequently used to limit the uses of property. There are several types of use restrictions, and it is necessary to recognize them to understand the implications of each. One type of use restriction maintains the character of a planned community, e.g., “commercial uses only”, or “office buildings only.” Another limits certain types of uses for the good of the community, e.g., “no rendering plants or other smelly operations allowed.” These types of restrictive covenants are readily enforced by the Courts, unless there is an interpretive problem with the draftsmanship. Another type of use restriction is designed to reduce or eliminate competition among neighboring tracts. For example, one retail tract may be allowed to have a drug store, but not a grocery store, and the neighbor will agree not to have a drug store, but may have a grocery store.

1. **Type of Store versus Line of Merchandise Restrictions.** Within the realm of restrictive covenants which restrict competition, there are two types of covenants, one which limits the type of store (for example a “grocery store”) and the other which limits the “line of merchandise” which may be sold. A modern grocery store sells many items. If the owner of one tract wishes to bargain for a restrictive covenant restricting the sale of over the counter drugs, he cannot simply draft a restriction permitting a grocery store and believe that he has protected his market, because the courts will allow the grocery store to operate as such stores evolve from time to time and sell substantial amounts of over the counter drugs, so long as the character of the store remains a “grocery store”. If there is to be an effective limitation on over the counter drugs, then that line of merchandise must be specifically identified and restricted. The actions of courts in interpreting and enforcing “type of store” clauses is illustrated by *New Braunfels Factory Outlet Center, Inc. v. IHOP Realty Corp.*, 872 S.W. 2d 303 (Tex. App – Austin 1994). There the court looked at menus and expert testimony to determine whether a Cracker Barrel operation was a “family-oriented coffee shop style restaurant” and therefore prohibited from going into the shopping center in violation of the restrictive covenant that IHOP had negotiated when it bought its pad and built its restaurant.

2. **Potential Antitrust Law Problems.** The type of restrictive covenant which limits competition among adjacent tracts may run afoul of antitrust law, and be voided. The Texas courts in the past allowed this kind of restrictive covenant when it was agreed to in connection with the grant or creation of an interest in land. See *Schnitzer v. Southwest Shoe Corporation*, 364 S. W. 2d 373 (Tex. 1963). This holding allowed competition restraining restrictive covenants in both leases and

reciprocal easement situations. The Texas Free Enterprise and Antitrust Act of 1983 (Texas Business & Commerce Code, Sections 15.01 to 15.26) removed the statutory language on which the earlier cases were based, and substituted language similar to the Sherman Act (the basic federal antitrust act). There has not been a case since 1983 to tell us whether the concepts of *Schnitzer* survived, or whether a different analysis may have to be employed.

- H. **Taxes.** Each owner will have easements and negative easements in the tracts owned by others in a typical commercial reciprocal easement and restrictive covenant situation. If the owner of one tract fails to pay his or her ad valorem taxes, does a tax foreclosure sale (the foreclosure of a lien which is superior to all other interests) destroy those easements and restrictions, thereby freeing the foreclosed tract from the program which restricts the rest of the properties? Until 1991, this may have been a problem, but in that year, the Legislature amended Section 32.05 of the Tax Code to specifically provide that the tax lien was subordinate to restrictive covenants and easements recorded prior to January 1 of the year in which the tax lien arose. That still allows worry about the priority of the tax lien for one year, but is a drastic improvement over the situation before the passage of the amendment.
- I. **Insurance and Repair After Casualty.** This kind of covenant is conceptually similar to the covenant for maintenance and repair. The neighbors want to see that a tract in a planned development is not left a burned out shell after a fire, and one way to see to that is to impose a requirement for insurance so that money will be available to fix up (or at least level and clean up) a site which suffers a casualty. In addition, a covenant to repair and rebuild may be imposed. Both of these may be personal covenants, rather than covenants running with the land.
- J. **Eminent Domain.** In a reciprocal easement situation, each owner will own his or her own tract and easements on the adjacent tract. In the event that one tract is taken, in whole or in part, the owner of the easement (the owner of the second tract in the reciprocal easement situation) loses easement rights and is thus entitled to a part of the condemnation award. This prospect will surprise and distress the owner of the fee interest in the tract taken. In order to avoid this result, the agreement must contain an assignment of the condemnation rights of the easement owner to the fee owner of the property taken.

III. Enforcement of Rights.

Easements, Covenants and restrictions are enforceable through the legal remedies usually available for enforcement of property rights and interests.

- A. **Suit for Damages.** An action for damages can be brought for an interference with rights under an easement. See *Hall v. Robbins*, 790 S. W. 2d 417 (Tex. App. – Houston [14th distr.] 1990, no writ. Because the wrong is in the nature of a trespass, exemplary damages may be available in certain situations. Logically, covenants, being basically agreements like all contracts, should have the remedy of damages available, although the usual remedy sought is injunction. If the covenant is one to pay assessments for common area maintenance or to refund the cost of self help remedy, the judgment will be for money.
- B. **Declaratory Judgment.** The remedy of declaratory judgment is available to determine interpretation and application of restrictive covenants. It may be joined with actions for damages or injunction.
- C. **Injunction.** The owner of easements rights may have an injunction to prevent or stop interference with those rights. The usual procedural rules apply and, since injunction is an equitable remedy, the principles of equity are applicable. The equitable principle requiring that there be no effective remedy at law, however, is not generally held applicable to cases of enforcement of easements and restrictive covenants. Nevertheless, the drafters of many documents (and the State Bar Forms Manual example attached) insert a provision specifically waiving this requirement.
- D. **Attorneys Fees.** Texas Property Code Section 5.006 mandates an award of attorneys fees in connection with enforcement of restrictive covenants. By its terms it does not apply solely to residential situations, so it may be available in commercial situations.
- E. **Owners' Associations and others Entitled to Enforce Restrictions.** At common law, a property owners' association is not allowed to enforce easements, restrictions or covenants, but may be given that power by the document creating the interests to be enforced. Texas Property Code, Chapter 202, gives standing to a property owners' association in both residential and non-residential planned projects as I read it. In addition, certain cities and counties are given enforcement of residential restrictive covenants under other provisions of the Property Code.
- F. **Civil Penalties.** Section 202.004 (c) of the Property Code provides for a civil fine of \$200.00 per day to be assessed in cases of violation of restrictive covenants. I have not heard or seen this provision used.
- G. **Termination of Reciprocal Rights.** If the agreement has been drafted to give the right of termination of the cross parking or cross easement rights as a remedy for default, then termination of such rights may be the ultimate remedy.

IV. Amendment of Agreements and Covenants.

Unless the document provides otherwise, all owners of the interests created by easements, covenants and restrictions will have to join in any modification or amendment. Tenants are generally not entitled to enforce or to join in amendments of easements and restrictions, but major tenants may negotiate specifically for such rights. Statutory provisions allow amendment of restrictive covenants in certain residential subdivisions, but these statutes do not apply to commercial projects. If a restrictive covenant contains a provision permitting its amendment, the Courts will allow amendment by the mechanism set out.

V. In Anticipation of Financing.

The attorney drafting easements, restrictions and covenants should do that work with the possible (or probable) need of an owner affected by the document to finance the property, or improvements on it. The features of an agreement containing easements, covenants and restrictions which lenders usually want to see are these.

- A. **Priority of Estates.** In my experience, lenders are usually willing to allow an easement and restrictive covenant document to be superior to their lien, unless the agreement just does not make economic sense. If you are financing the property before the restriction and easement agreement is negotiated or finalized, you may need to provide for the subordination of the lien of the lender to the easements and covenants, once recorded. Other lawyers have reported to me that some lenders want to be superior to the provisions concerning use of casualty and eminent domain proceeds, but I have not dealt with that.
- B. **Estoppel Certificates.** Both the lender and the parties involved in the arrangement will want a provision that requires delivery of estoppel letters or certificates to determine whether any default or claim currently exists.
- C. **Liens and Lien priorities.** If part of the program of the easements and covenants requires the payment of contributions toward maintenance of common areas, and that payment obligation is secured by a lien, most lenders will want their lien superior to that lien. They may be willing to accept a provision that the collection lien is subordinate but will survive a foreclosure of the superior lender's lien, only to enforce collection of sums coming due after the foreclosure by the lender.
- D. **Restrictions on Amendment.** If the scheme of the easements and covenants is beneficial to the project (as it should be) then the lender may want to restrict amendment of it by the borrower without joinder or consent of the lender. Major tenants may also want covenants from the property owner that a beneficial provision will not be released or amended without their consent or

joinder.

VI. The Property Owners' Association in the Commercial Context.

In planned developments having entries, boulevards with landscaping areas, stormwater detention ponds and the like, the developer may plan and create a property owners' association to administer the scheme of the easements covenants and restrictions after the developer has sold out the project. Such an association is usually organized as a nonprofit corporation, although unincorporated associations and other forms may be used. The primary issues with respect to such associations is the amount of assessment that the association can require and the division of authority between the developer and the property owners. With respect to owners' associations in commercial projects, there is no law that provides limits on the plans for the association that the developer adopts. A purchaser must either be satisfied with the financial arrangements and the authority of the association, negotiate changes with the developer, or simply not purchase property in the project.

Property owners' associations in commercial projects differ from associations in residential projects in one major aspect and that is taxation at both the federal and state levels. The use of a nonprofit corporation does not by itself give tax relief to the association. A residential owners' association, however, may be exempt from franchise tax by the State of Texas under section 171.082 of the Tax Code. Likewise, residential owners' associations, but not commercial property associations, may be exempt from federal income taxation under Section 528 of the Internal Revenue Code and its regulations. That complicated provision requires that a qualifying association obtain most of its income from dues and assessments of property owners and that it have limited amounts of income from other sources. The difference in tax treatment means that it is difficult for owners' associations in commercial projects to accumulate reserves for capital repairs and maintenance, but much easier for residential associations.

VII. Miscellaneous

- A. Draft for the Long Term.** The work of planning and drafting easements, restrictions and covenants requires that you spend some time with your client to understand his or her plans for the project and the physical situation of the project. This is true of both the two party reciprocal agreement as well as the multiple site planned project. Do your best to anticipate and deal with the problems and situations that may arise. Accumulate and review forms from other lawyers. Borrowing of forms is certainly one of the highest forms of flattery in our profession. Say thanks if you do.

- B. Bankruptcy Law Considerations.** There is some uncertainty about the treatment of easements, restrictions and covenants in bankruptcy cases. The problem goes back to the distinction between covenants that are negative easements and thereby interests in land, and those that are merely covenants, and possibly executory contracts. Completed conveyances of interests in property are not subject to being set aside by a Bankruptcy Court. Executory contracts,

however, may be rejected by a bankrupt party under Section 365 of the Bankruptcy Code. Can an owner of a tract reject some or all of the covenants of a restrictive covenant agreement and thereby relieve himself and his property of the burdens of the agreement? It seems that covenants to repair, to carry insurance and the like are most vulnerable to such a challenge. There have been some scholarly articles on this issue, but no cases which determine the answers.

- C. **Title Insurance.** Easements are insurable in title policies in Texas. The easements created in a reciprocal agreement or in a declaration for a planned development should be insurable to a purchaser or a lender without material additional cost. The attorney will have to ask for that coverage, because the title companies will rarely if ever volunteer such coverage.