Private Transfer Fee Covenants: Cleaning Up The Mess

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PRIVATE TRANSFER FEE COVENANTS:
CLEANING UP THE MESS

R. Wilson Freyermuth

Editors' Synopsis: The purposes for creating a "private transfer fee" covenant range from supporting community services to creating a future revenue stream for the developer. Traditionally, courts examined these covenants using the touch and concern standard. The Restatement (Third) of Property: Servitudes, however, rejects this standard. This Article discusses this new approach as it relates to private transfer fees. The author argues that private transfer fee covenants are contrary to public policy and encourages states to enact legislation limiting the enforcement of these covenants.

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Assume that ten years ago, Homeland Development Company (Homeland) acquired a parcel of land that it subdivided into the proposed development of Sea View, an upscale, covenant-restricted residential community. In the recorded declaration for Sea View, Homeland imposed a “reconveyance fee” covenant, which was binding for a period of ninety-nine years, upon each lot. This covenant required the payment to Homeland of a fee upon each resale of each lot following Homeland’s original transfer in an amount equal to 1% of the price in the relevant resale. The covenant further provided that if a transfer occurred and the buyer/seller did not pay the fee, a lien would arise in favor of Homeland to secure the transfer fee.

Now assume that Bob and Nancy Smith, who purchased a home in Sea View from Homeland nine years ago, recently sold the home to Paul and Joanne Grant for $500,000. Several related questions now arise: Is Homeland entitled to collect a $5,000 transfer fee from the Smiths? Will a valid lien against the home arise if the Smiths do not pay the transfer fee? And will the obligation to pay this fee upon a future resale bind the Grants—will
this transfer fee covenant "run with the land" to bind successor owners of lots within Sea View?

Under the traditional formulation for the enforcement of covenants running with the land, the burden of a covenant did not run to bind a successor to the covenantor unless both the benefit and the burden of the covenant in question "touched and concerned" the land. The transfer fee covenant described above is an affirmative covenant to pay money, and while the enforcement of such covenants has a somewhat checkered history, both the benefit and the burden of an affirmative covenant to pay money can touch and concern land. The classic example in modern common interest development is the lot assessment covenant, which imposes an assessment on each lot (typically payable to a homeowners’ association) to fund community services and the maintenance of community facilities. Because these services and amenities benefit community residents directly (for example, by providing access to pools and parks) or indirectly (for example, by preserving property values through maintenance of desired amenities), both the burden and benefit of the typical lot assessment covenant touch and concern land.

But in the hypothetical Sea View development, the transfer fee is payable to Homeland, the developer, and not to the owners’ association; in other words, the transfer fee is a private transfer fee. When Homeland attempts to enforce this fee upon a future transfer, Homeland likely will have sold all lots within Sea View and will no longer have any interest—other than reputation—in the community. In this context, the benefit of the private transfer fee covenant is personal to Homeland. In the language of the common law, the covenant is a benefit "in gross." Under the traditional common law of real covenants, in cases in which the benefit of a covenant was in gross, the burden of that covenant did not run to bind successors to the original covenantor.

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1 See the original RESTATEMENT OF PROP. § 537 (1944); WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY § 8.15 (3d ed. 2000); see also RICHARD R. POWELL & PATRICK J. ROHAN, POWELL ON REAL PROPERTY §§ 675 (1968); 2 AMERICAN LAW OF PROPERTY § 9.13 (1952).


The publication of the Restatement (Third) of Property: Servitudes (Third Restatement) in 2000 has called into question the status of the touch and concern standard. The Third Restatement purports to abandon the touch and concern standard, and substitutes a standard under which a covenant is a servitude (enforceable against successors) unless the covenant is arbitrary, spiteful, capricious, or creates an unreasonable restraint on alienation or trade.\(^5\) In cases in which a covenant imposes only an indirect restraint on alienation—as would be the case with a private transfer fee covenant—the Third Restatement provides that the covenant does not create an unreasonable restraint on alienation unless it "lacks a rational justification."\(^6\)

Relying in part upon this change in the Third Restatement, a developer like Homeland will argue that a private transfer fee covenant does not create an unreasonable restraint on alienation of the affected land. Instead, Homeland will argue, the affected land will trade freely in the market, albeit at a slightly reduced price because each buyer will discount its purchase price slightly to account for the future obligation to pay a transfer fee upon resale. Further, Homeland might argue, this slight price reduction serves a rational purpose in that it benefits prospective buyers by lowering their acquisition cost and some of their carrying costs, such as mortgage interest and real estate taxes, and thus facilitates home acquisition.\(^7\) Under this view, Homeland will argue, Homeland should be allowed to collect its transfer fee from the Smiths and enforce the covenant against the Grants and all other successor owners of the affected parcel.

In the wake of the Third Restatement, developers have begun imposing private transfer fee covenants at an accelerating pace. As of January 2010, one marketer of private transfer fee covenants, Austin, Texas-based Freehold Capital Partners, working in conjunction with developers and homebuilders, claimed to have imposed ninety-nine-year private transfer fee covenants upon land in forty-three states with a total market value of approximately $600 billion.\(^8\) Several developers, including the St. Joe Company and Lennar Homes, have also used transfer fee covenants to fund nonprofit organizations that provide services that bear either no relationship or at best

\(^5\) See Restatement (Third) of Prop.: Servitudes § 3.1 (2000).
\(^6\) Id. § 3.5(2) ("A servitude that lacks a rational justification is invalid.").
\(^7\) See infra notes 152–62 and accompanying text.
Private Transfer Fee Covenants

Other real estate industry groups have reacted to this trend with alarm. For example, brokers fear that a buyer often will not discover the existence of a private transfer fee covenant until the buyer obtains and reviews a title insurance commitment well after the signing of the contract. Such late discovery may scuttle or threaten the closing of the sale if the buyer attempts to use the existence of the covenant as a basis to escape the contract or renegotiate a lower price. Title insurers also express concern about the increasing use of private transfer fee covenants, due to both the uncertainty regarding the enforceability of such covenants and the risk of missing such covenants in the search process and thus not excluding them from policy coverage. Further, because both brokers and title insurers receive compensation, directly or indirectly, based upon a percentage of the sale price, they understandably take a dim view of covenants that may reduce sale prices.

Broker and title industry groups have reacted by going directly to state legislatures and seeking outright bans on the enforcement of private transfer fee covenants. These efforts have met with increasing, but not yet universal, success. Seventeen states have adopted statutory bans on the enforcement of private transfer fee covenants, and the Joint Editorial Board for Uniform Real Property Acts has unanimously recommended that states adopt a statutory prohibition on the enforcement of private transfer fee covenants. Consistent with this recommendation, representatives of the American Land Title Association (ALTA) and the National Association of Realtors (NAR) have prepared a model statute, which appears as an Appendix to this ar-

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10 Unless a contract of sale provides otherwise, the seller must provide marketable title at closing. See STOEBUCK & WHITMAN, supra note 1, § 10.12, at 775. The presence of a private transfer fee covenant constitutes an encumbrance that renders title unmarketable unless the buyer has expressly agreed to take title subject to the covenant. See id. at 781.

11 The title insurer will calculate its premium based upon the insured amount. The insured amount does not have to be equivalent to the sale price—a buyer of land could choose to take less coverage and partially self-insure—but typically the two are equal.

12 See infra notes 191–92 and accompanying text.

13 R. Wilson Freyermuth, Putting the Brakes on Private Transfer Fee Covenants, PROB. & PROP., July/August 2010, at 20, 24.

article. These groups hope to obtain widespread introduction and adoption of similar legislation during the 2010-2011 legislative cycle.

This Article provides a comprehensive evaluation of private transfer fee covenants and ultimately concludes that state legislation prohibiting the enforcement of such covenants is justified. Part I of the article discusses the basic structure of transfer fee covenants and explains why private transfer fee covenants are attractive to developers and homebuilders. Part II discusses the common law touch and concern standard and explores how courts have used, or not used, the standard in evaluating the enforceability against successors of various types of contract rights that are somewhat analogous to transfer fee covenants. Part III addresses whether enforcement of private transfer fee covenants as servitudes is justified as a matter of sound land policy under either the common law or the Third Restatement and concludes that the answer is no. Part IV encourages state legislatures to enact statutes akin to the ALTA/NAR model statute that prohibit or limit the enforcement of private transfer fee covenants.

I. THE ECONOMICS OF TRANSFER FEE COVENANTS (PRIVATE AND OTHERWISE)

By imposing a transfer fee covenant, the developer seeks to obtain a stream of future revenues by collecting a transfer fee upon all future resales. The legitimacy of such fee covenants—perceived or real—may vary depending upon the person or organization to whom the fees are payable and the purposes to which such fees are to apply. This Part outlines three different types of transfer fee covenants in current use. The first imposes a fee payable to an owners’ association to fund community services, amenities, or both. The second imposes a fee payable to a nonprofit organization to fund the organization’s operations or activities, which may or may not be directly or indirectly related to the ownership of the affected lot. The third imposes a fee payable to the developer for which the lot owner receives no continuing services or benefits beyond acquisition of the land. While this article primarily focuses on the third type of fee, the private transfer fee, this Part addresses the economics of all three to provide the appropriate context for evaluating whether the law should permit the imposition of private transfer fee covenants.

A. Transfer Fees Payable to a Homeowners’ Association

Within a common interest community, the Homeowners’ Association (HOA) functions in a quasi-governmental role by providing public services (such as rule enforcement and communication) and by maintaining community facilities (such as parks, pools, and recreational facilities) for the bene-
fit of community residents. Just as a municipality must levy taxes and fees to finance the cost of municipal governance, the HOA must levy comparable charges to finance its functions on behalf of the community. Typically, HOAs generate funding through covenants that impose a periodic assessment on lot ownership within the defined community, much as municipalities impose ad valorem real estate taxes upon municipal residents.15

Municipalities, however, are not limited to ad valorem taxation to raise revenues and commonly impose transaction-based taxes such as sales taxes, permit fees, and impact fees to fund municipal governance. Likewise, an HOA could, if the common interest declaration authorizes it, fund community services through transaction-based fees. For example, a declaration could impose a transfer fee, payable to the HOA, upon all future transfers of land within the common interest community. Documents establishing cooperative housing often impose such a fee, sometimes called a "flip tax." One might characterize this fee as a community transfer fee; the money it generates funds services and amenity maintenance within the relevant community, thus benefitting the community’s residents, at least indirectly.

For example, the HOA for a cooperative typically has the right to approve prospective purchasers, and many cooperatives exercise that approval right with great seriousness.16 As a result, the transfer of a cooperative apartment can involve nontrivial transaction costs for the HOA. The community could fund these costs from periodic assessments, but the declaration might instead authorize the HOA to fund them by imposing a transfer fee, thus placing the costs upon the person responsible for them—the seller—rather than the community as a whole. Alternatively, if the declaration permits, the HOA might impose a transfer fee to fund a portion of its regular operating costs to avoid increases in periodic assessments—no differently than a municipality might increase sales or other transaction taxes.


16 See, e.g., Max Abelson, 820 Fifth Claims Another Boldface Turn-away; Even Call from Hizzoner Doesn’t Help, THE N.Y. OBSERVER, May 26, 2009 (discussing rejection of $31 million purchase by developer Jeff Blau and noting co-op board had previously rejected Ron Perelman, Steve Wynn, and oil heir Fred Koch); see also Michael Decourcy Hinds, When a Co-op Board Rejects a Buyer, N.Y. TIMES, November 2, 1986; Carol E. Levy, Top Dozen Reasons for Co-op Board Rejections, THE COOPERATOR (May 2007); Teri Karush Rogers, Co-ops, Condos, and Secondhand Smoke, N.Y. TIMES, August 6, 2006.
to maintain a lower ad valorem tax rate. Finally, if the declaration permits, the HOA might choose to levy a transfer fee to promote community stability and avoid the disruption caused by speculators seeking to purchase and immediately flip units.17

In theory, this type of transfer fee covenant has a neutral impact on the value of land within the development. Certainly, if a buyer knows of the covenant—and thus is aware that she must pay a 1% fee upon a future resale—the buyer should factor this covenant into her offer price. Viewed in isolation, that knowledge will result in a lower offer price. However, the fee will also benefit the buyer to the extent that it funds community services and amenities that may preserve or enhance the value of land. Further, the fee may enable the HOA to maintain relatively low periodic assessments. This benefit roughly offsets the obligation inherent in the transfer fee covenant, and thus, the covenant should not reduce the market value of the affected land.

B. The “Quasi-Public” or “Charitable” Transfer Fee Covenant

In some common interest developments, covenants may impose transfer fees that are payable, not to HOAs, but to nonprofit organizations to fund the organizations’ activities. In some cases, these activities may have a direct and substantial relationship with the development in question. For example, suppose that Developer seeks approval to locate a large residential community called Sunrise on a parcel of land that includes a habitat for endangered birds. As a condition of the approval, local municipal planners require Developer to set aside 25% of the parcel in its undeveloped condition to minimize the development’s environmental impact. The Developer creates the Sunrise Community Foundation (SCF), a nonprofit organization to which Developer will convey a conservation easement over the land subject to the set-aside. SCF will manage the land subject to the conservation easement and carry out environmental education and awareness programs within the local area. Rather than funding SCF’s operation through periodic assessments, Developer instead might impose a covenant that requires sellers to pay a 1% fee to SCF upon all future sales of lots within Sunrise. While this fee will have an impact upon all buyers within Sunrise, the benefit to the general public (preservation of environmentally sensitive land and

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17 Commentators have lamented the role that speculative purchasing has played in promoting and aggravating the current real estate crisis. See, e.g., George Lefcoe, Should We Ban or Welcome “Spec” Home Buyers?, 36 J. LEGIS. 1, 17 (2010); Ngai Pindell, Fear and Loathing: Combating Speculation in Local Communities, 39 U. MICH. J.L. REFORM 543 (2006).
environmental education) and to the individual Sunrise residents (potential enhancement in the value of lots within Sunrise created by proximity and/or access to the conserved land) arguably may offset this impact.¹⁸

In other circumstances, a developer might impose a transfer fee to support a public or charitable purpose that is not related—or is at best tangentially related—to the development. One notable, real-world example is the Lennar Charitable Housing Foundation (LCHF). In many of its developments, Lennar Homes imposes a transfer fee covenant requiring payment to LCHF of a small fee—0.05%—upon all future transfers of land within the development.¹⁹ LCHF does not own or manage any property within any of the affected developments and does not create or operate low-income housing. Instead, LCHF provides grants to social service agencies that provide support for the homeless and those living in substandard housing.²⁰ Because the LCHF transfer fee provides for no services or facilities benefitting owners within any development, one expects such a covenant to have only a negative impact upon the value of the affected lots. One might nevertheless defend the LCHF covenant as justified based upon its general charitable purpose and the fact that its small fee only has a de minimis effect on the land’s value.²¹

¹⁸ Under current law, the SCF transfer fee covenant is likely enforceable, at least to the extent the underlying conservation easement is enforceable. Certainly, if an HOA owns and manages the set-aside land directly as a common element, the HOA could impose assessment or transfer fee covenants to fund the maintenance and preservation of that land. See supra note 3. Because the creation of SCF and the conservation easement facilitates the preservation of the set-aside land, a court likely will conclude that the transfer fee covenant does touch and concern all land within Sunrise—both the set-aside land subject to the conservation easement and each lot within Sunrise, the value of which could benefit from proximity to the conservation area. Likewise, under the Third Restatement, a court likely will enforce the SCF transfer fee covenant because a “rational justification” supports it. See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.5 illus. 7 (2000) (rational justification supports a 1% transfer fee covenant to finance foundation to manage environmentally sensitive land and carry out environmental education programs).


²¹ The LCHF transfer fee is only 0.05%, or $150, on the sale of a $300,000 home. Fees supporting charitable foundations, however, could be larger in size, and the larger the fee, the greater an impact it will have upon the value and alienability of the affected land. Nevertheless, courts frequently have upheld even substantial restraints on alienation where the conveyances subject to the restraints advanced public purposes, charitable purposes, or both. See, e.g., Johnston v. City of L.A., 168 P. 1047 (Cal. 1917) (upholding defeasance in deed to city requiring use of land as a dam); Merchants Bank & Trust Co. v. New Canaan
C. The Purely Private Transfer Fee Covenant

This covenant involves transfer fees that are payable to a private party—most commonly, a developer—and bear no relationship to the development or the affected residents other than the imposition and collection of the fee itself. The example in the introduction best reflects this type of covenant. In that example, no fee arises on the original sale from Homeland to the Smiths. However, when the Smiths later sell their home to the Grants for $500,000, the covenant, if enforceable, obligates the Smiths to pay Homeland a $5,000 fee. Likewise, if ten years later, the Grants resell the home to the Clintons for $600,000, the covenant will obligate the Grants to pay Homeland another transfer fee in the amount of $6,000.

The private transfer fee covenant should reduce the value of the affected land relative to comparable land not subject to such a covenant. If the Smiths are aware of the covenant, they should account for the future transfer fee obligation by reducing their offer price to Homeland. Further, because the fee does not fund services or maintenance of any amenities within Sea View, the Smiths receive no corresponding benefit that will offset this future transfer fee obligation. Thus, imposing the covenant will reduce the amount Homeland will receive from the sale of the land.

Why, then, would Homeland impose the covenant? Presumably because Homeland expects to make up the lost revenue—and perhaps more—in collecting future transfer fees. Assuming the typical house is sold every seven years, if Homeland imposes a transfer fee covenant upon all 500 lots with-

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Historical Soc'y, 54 A.2d 696 (Conn. 1947) (upholding defeasance restriction in deed benefiting New Canaan Library Association); Dunne v. Minsor, 143 N.E. 842 (Ill. 1924) (upholding defeasance restriction in deed to church for use as residence for local priest). Under this approach, a court might enforce a charitable transfer fee as a reasonable restraint by implicitly or explicitly concluding that the covenant furthers a public or charitable benefit that outweighs the burden on the affected land.


23 This number is frequently cited, but its accuracy is unclear. See, e.g., Walter R. DeRieux, John D. Benjamin & Norman G. Miller, Estimating User Costs and Rates of Return for Single-Family Residential Real Estate, 8 J. REAL EST. PRAC. & EDUC. 1, 1 (2005). According to the National Association of Realtors' 2008 Profile of Home Buyers and Sellers, sellers of detached single-family homes during 2008 had owned their home for a median of seven years, while more than four in ten condominium sellers had owned their units for only three years or less. NAT'L ASS'N OF REALTORS, PROFILE OF HOME BUYERS AND SELLERS 9 (2008). This data was based only on surveys of sellers, however, so it most likely understates the average holding period for all homes.
in the Sea View community, Homeland expects the covenant to produce approximately 7,000 transfer fees over the ninety-nine-year period of the covenant.\footnote{24} In this respect, the present value of the private transfer fee covenant’s revenue stream could be as high as 4-5\% of the improved value of the affected land.\footnote{25} By contrast, because the Smiths will only be liable for payment of the first transfer fee, the Smiths may only discount their offer price by 1-2\%, which is the perceived impact of the fee on their finances.\footnote{26} If so, the transfer fee covenant provides Homeland with a means to increase its return on the Sea View development.\footnote{27} This is especially true if Homeland has an effective mechanism to sell the transfer fee covenant rights immediately, such as by pooling together transfer fee rights and selling them in a private placement or issuing and selling securities backed by the transfer fee rights.\footnote{28} Further, Homeland may use the presence of the transfer fee covenant as a positive in its marketing efforts—telling prospective buyers that the covenant enables them to obtain the land at a discount relative to similar land that is not subject to such a covenant, thus lowering their acquisition cost and potentially some transaction and carrying costs.\footnote{29}

\footnote{24} If each lot sells every seven years, each lot will be transferred approximately fourteen times in the ninety-nine-year period of the covenant. Multiplying the five hundred lots by the fourteen transfers per lot gives a total of seven thousand transfers.

\footnote{25} An earlier version of Freehold Capital Partners’ promotional brochure stated, “Recent valuations have indicated that 5\% of the final improved value of the property is a reasonable initial assumption for most developments.” This assertion no longer appears, however, in the current \textit{Freehold Brochure}.

\footnote{26} The \textit{Freehold Brochure} provides a hypothetical example that suggests a home subject to a 1\% transfer fee covenant will sell for 2\% less than a comparable unrestricted home. \textit{See Freehold Brochure, supra} note 8, at 3.

\footnote{27} Theoretically, if a knowledgeable buyer appreciates that the future stream of transfer fees has a present value of 5\% of the unrestricted value of the land, the knowledgeable buyer will demand a discount closer to that 5\% expected value. As discussed in Part III, however, the typical residential buyer lacks the ability to price the effect of a transfer fee covenant with accuracy.

\footnote{28} In its brochure, Freehold Capital Partners suggests that it actively works with developers to identify ways to monetize the developer’s transfer fee stream through “hedge funds, pension funds and similar institutions as well as the public markets.” \textit{Freehold Brochure, supra} note 8, at 4.

\footnote{29} \textit{See infra} notes 152–54 and accompanying text.
II. PRIVATE TRANSFER FEE COVENANTS AND THE TOUCH AND CONCERN STANDARD

A. The Touch and Concern Standard and Its Parameters

Under traditional common law rules, for a covenant to run with the land and bind successors as a "real covenant" (enforceable in an action at law for damages) or an "equitable servitude" (enforceable in equity through injunctive relief), the covenant had to touch and concern land. The touch and concern standard traces its origins to *Spencer's Case*, in which a lessee had agreed for himself and his assigns to build a brick wall upon the demised premises, but the King's Bench refused to enforce the covenant against the lessee's assignee:

But although the covenant be for him and his assigns, yet if the thing to be done be merely collateral to the land, and doth not touch or concern the thing demised in any sort, there the assignee shall not be charged. As if the lessee covenants for him and his assigns to build a house upon the land of the lessor which is no parcel of the demise, or to pay any collateral sum to the lessor, or to a stranger, it shall not bind the assignee, because it is merely collateral, and in no manner touches or concerns the thing that was demised, or that is assigned over; and therefore in such case the assignee of the thing demised cannot be charged with it, no more than any other stranger.

Over time, courts have used the term touch and concern as a label to identify covenants that are so related to land ownership that sound policy justifies their enforcement against successor owners of the affected land.

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31 Id. at 74. At first blush, one might view a covenant to build an improvement upon certain land as satisfying the touch and concern standard. See, e.g., *Stoebuck & Whitman*, supra note 1, § 8.15, at 475. *Spencer's Case*, however, distinguished between a covenant that extends to a thing "in being" at the time the covenant is made (e.g., a covenant to repair an already constructed building) and one that relates to a thing not in being at that time (e.g., a covenant to build on otherwise undeveloped land). See 77 Eng. Rep. at 74. The court in *Spencer's Case* held that the former was binding against an assignee but not the latter. See id.
32 See Cribbet & Johnson, supra note 2, at 383 ("The purpose of [the touch and concern] requirement is said to be to prevent the serious restraint on alienability of land that might occur if landowners could impose upon subsequent owners obligations totally unrelated to the land of either party."); see also Stewart E. Sterk, *Freedom from Freedom of Contract: The Enduring Value of Servitude Restrictions*, 70 Iowa L. Rev. 615, 646-49 (1985); James L. Winokur, *The Mixed Blessings of Promissory Servitudes: Toward*
Significantly, in interpreting this standard, courts traditionally required the party seeking to enforce a covenant against a successor to establish that both ends of the covenant—both the benefit and the burden of the covenant—touched and concerned land.\(^3\)

For a typical restrictive covenant imposed in common interest development—for example, a covenant restricting land’s use to single-family residential use only—the touch and concern requirement poses no analytical difficulty. The touch and concern requirement became problematic for courts as they evaluated affirmative covenants—ones that obligate the owners of affected parcels to pay money or perform some service during their periods of ownership. Traditionally, English courts refused to enforce the burden of an affirmative covenant against a successor to ownership of the burdened land, at least outside the context of leases.\(^4\) In this way, English law prevented fee simple landowners from re-creating modern versions of feudal obligations\(^5\) and thereby restricting the marketability of land.\(^6\) Influential early American decisions incorporated this prohibition on affirmative burdens running with land—most notably the New York Court of Appeals in *Miller v. Clary*,\(^7\) which held that a covenant by the owner of a mill to provide power to a neighboring parcel did not run with the land to bind the successor owner of the land on which the mill was located.

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33 See Restatement of Prop. § 537 (1944); Cribbet & Johnson, supra note 2, at 384 (3d ed. 1989); Stoebuck & Whitman, supra note 1, § 8.15, at 475.


36 See Restatement (Third) of Prop.: Servitudes § 3.1 cmt. k (2000).

Affirmative burdens create greater risks than negative burdens because performance requires resources in addition to those needed to acquire the burdened property, and liability for failure to perform usually persists until the burdened property is transferred to another. Purchasers of property burdened by a negative servitude ordinarily risk only the assets invested in the property; purchasers of property burdened by an affirmative servitude risk their other assets as well.

Id.

37 103 N.E. 1114 (N.Y. 1913); see also Eagle Enters., Inc. v. Gross, 349 N.E.2d 816, 820 (N.Y. 1976) (“The affirmative covenant is disfavored in the law because of the fear that this type of obligation imposes an ‘undue restriction on alienation or an onerous burden in perpetuity.’” (quoting Nicholson v. 300 Broadway Realty Corp., 164 N.E.2d 832, 835 (N.Y. 1959))).
Over time, courts began to see that a blanket prohibition on affirmative covenants would limit common interest development patterns unduly. Common interest development typically includes services and facilities available to all owners within the development, such as recreational facilities (for example, pools and parks) and community management (for example, enforcement of community land use restrictions through an owners' association). Buyers may value these services and facilities, but providing them involves substantial expense, both in hard development (for example, the costs of building a pool) and ongoing maintenance (for example, the costs of repairing and operating the pool). Common interest development typically finances the latter costs through covenants to pay a periodic assessment to the HOA. Such an affirmative assessment covenant does not unreasonably burden the alienability of assessed lots.\(^3\) By ensuring the HOA can generate the funds needed to maintain the common amenities—and thereby preserve the resale value of each lot—the assessment covenant ostensibly benefits the owner of each affected lot. For this reason, American courts gradually adapted the traditional prohibition against affirmative covenants and concluded that an affirmative covenant for lot assessments within a common interest development does touch and concern land.\(^3\)

Some covenants, however, create payment obligations that provide in gross benefits to the covenantee—the covenantee neither owns an estate in any land benefitted by the performance of the covenant nor acts on behalf of such an owner. In this situation, courts often retained the traditional disfavor of affirmative covenants and held that where the benefit of a covenant was in gross, the burden of the covenant would not run to bind a successor to the original covenantor.\(^4\) Section 537 of the original Restatement of Property adopted this view.\(^4\)

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\(^4\) See, e.g., id.


\(^4\) Section 537 provides the following:

The successors in title to land respecting the use of which the owner has made a promise can be bound as promisors only if (a) the performance of the promise will benefit the promisee or other beneficiary of the promise in the physical use or enjoyment of the land possessed by him, or (b) the consummation of the transaction of which the promise is a part will operate to benefit and is for the benefit of the promisor in the physical use or enjoyment of land possessed by him, and the burden on the land of the promisor bears a reasonable relation to the benefit received by the person benefited.

Restatement of Prop. § 537 (1944).
The if-the-benefit-is-in-gross-the-burden-won’t-run rule operated as a particularized, if perhaps overbroad, application of the general rule against unreasonable restraints on alienation. Because the burden of a covenant had the potential to limit the alienability of the affected land, enforcement of a covenant had to benefit the affected land or some neighboring parcel so as not to decrease the overall utility of land. Courts traditionally applied this principle in prophylactic fashion: whether a covenant that created personal benefits was actually a substantial burden on the alienability of the land was irrelevant.\footnote{See, e.g., \textit{Cribbet \& Johnson}, supra note 2, at 384 (noting that the appeal of the both-ends-must-touch-and-concern rule “may have been that it spared courts the difficult task of evaluating the worth of an infinite variety of benefits and interests that imaginative drafters might seek to advance through covenants burdening land.”).} If the covenant created a benefit personal to the covenantee, the burden of that covenant would not bind successors even if the actual burden on alienability was \textit{de minimis}.\footnote{See, e.g., \textit{Montgomery}, 22 S.W.2d at 463 (Tex. Civ. App. 1929) (refusing to enforce gasoline purchase requirements contract against successor even though agreement was by its terms enforceable against a successor for only one year); \textit{Bremmeyer Excavating, Inc. v. McKenna}, 721 P.2d 567 (Wash. Ct. App. 1986) (refusing to enforce covenant to fill the affected land against successor owner even though covenant by its terms had only a five-year term).} In this respect, the rationale for the prophylactic touch and concern rule was similar to the rationale of the traditional what-might-happen Rule Against Perpetuities (RAP) test.\footnote{Under the what-might-happen test, it did not matter that a particular contingent interest was unlikely to vest remotely; the law’s pro-alienability policy justified a prophylactic rule that any interest that could vest too remotely was void from the beginning even if the actual risk of remote vesting was trivial. \textit{See}, e.g., \textit{Jee v. Audley}, 29 Eng. Rep. 1186 (1787) (invalidating executory interest in the daughters of Elizabeth Jee because Jee was presumed capable of having additional children, although Jee was 70 years old at the time of the conveyance).}

B. The Touch and Concern Standard as Applied to Contract and Payment Rights

As discussed in Part II.C, the Third Restatement purports to abandon the touch and concern standard, calling into question the if-the-benefit-is-in-gross-the-burden-won’t-run rule. To provide context for why the Third Restatement took this approach, this Subpart reviews how, or in some cases, whether, courts applied the traditional touch and concern standard to contract rights that are analytically similar to private transfer fee covenants.

Theoretically, the traditional rule should discourage landowners from imposing covenants that create only personal benefits. But in practice, this \textit{in terrorem} effect is incomplete. Some landowners may impose such
agreements in ignorance of the rules restricting the enforceability of covenants in gross. Furthermore, at the margin, courts have struggled to determine whether a particular covenant actually benefits land. As a result, courts have frequently addressed the extent to which an agreement can bind title to land if the agreement does not provide a direct benefit to the use and enjoyment of land. This Article discusses the provisions of the Third Restatement and evaluates whether and to what extent a private transfer fee covenant should be enforceable.

1. Option Contracts

Sometimes, a grantor of land will convey fee simple title subject to an option permitting the grantor/optionee to reacquire that title in the future. Theoretically, one could characterize an option to purchase land as a covenant and evaluate whether it should run with title to the land to bind a successor to the grantee/optionor. Under this approach, one could argue that the benefit of an option contract is personal to the optionee—at least if the optionee has no present possessory interest in the optioned land or surrounding land. If a court applies the traditional touch and concern principle, one might argue that the burden of the option—the obligation to convey title upon exercise—should not bind a successor. This argument, however, seems problematic: the benefit of the option contract is nominally land-related because the benefit enables the optionee to acquire title to the land. Furthermore, the option may have influenced the price at which the optionor acquired the land in the first instance, so nonenforcement could significantly disrupt the optionee's expectations.

In reality, courts have chosen not to treat option contracts under the law of covenants and have instead treated an optionee as the holder of an equitable future interest in the optioned land. As a result, courts have enforced options unless they violated RAP or created an unreasonable restraint on alienation—if the option price would unreasonably deter transfer or development of the land. This approach seems analytically preferable; if the

45 As Justice Lehman noted in Neponsit, "[W]hether a particular covenant is sufficiently connected with the use of land to run with the land, must be in many cases a question of degree." Neponsit, 15 N.E.2d at 796.

46 See id.


48 See, e.g., Iglehart v. Phillips, 383 So. 2d 610 (Fla. 1980) (repurchase option of unlimited duration was unreasonable restraint on alienation where option price equaled
parties factored the option into the sale price and the option is recorded to give notice to subsequent purchasers, no good reason exists to frustrate the optionee's bargain if the option does not seriously affect the land's alienability or discourage its development. The impact on alienability and development will depend upon the option price. If the agreement requires the optionee to pay market value at the time of exercise, the option should not seriously affect the land's alienability or discourage its development. By contrast, a fixed-price option could discourage the owner from improving or developing the land, depending upon the option's price and duration. But many courts that have struck down fixed-price options concluded that the option violated RAP—itself traditionally a prophylactic rule—without reaching the more nuanced conclusion that the option was an unreasonable restraint on alienation. 49

2. Rights of First Refusal

The right of first refusal (ROFR) is a close relation to the option, giving its holder, the preemptionee, the right to acquire title only if the owner of the affected land, the preemptioner, contracts to sell it. One might characterize a ROFR as a type of covenant, the benefit of which is purely personal to the preemptionee, and conclude that the burden of the ROFR will not run with title to the land. A few decisions have taken this approach. 50 One particularly noteworthy decision is Feider v. Feider, 51 in which the Washington Court of Appeals held that a ROFR was a personal contract and did not run with the land to bind a successor to the preemptioner:

Neither do we find evidence the agreement "touches and concerns" land. To satisfy this requirement, the agreement must have rendered less valuable [the preemptioner's] legal interest in his land and rendered

51 699 P.2d 801 (1985). Feider involved a parcel of land originally held in co-ownership by the Feider siblings and partitioned in kind. See id. at 802. Francis Feider received fee ownership of this parcel in partition and granted a ROFR to his brother Andrew, the owner of the adjacent parcel. Twenty-nine years later Francis sold his parcel following Andrew's death but without giving notice to Andrew's heirs, who later sued for specific performance of the ROFR. See id.
more valuable the legal interest of [the preemptionee] in his land. . . . [N]o interest in land is created by a right of first refusal; only personal rights are affected. 52

From a policy perspective, the result in Feider appears unsatisfactory. The ROFR did not obligate the preemptioner to sell at a price he was not willing to accept. Because the preemptioner could command a market price, he had no disincentive to improve or develop the land; thus, the court had no good reason to refuse to enforce the ROFR.

Some courts have enforced ROFRs by stretching to conclude that the ROFR is a covenant that touches and concerns land. 53 Most courts, however, have avoided the touch and concern thicket by evaluating ROFRs like options and treating them as a type of contingent interest subject to analysis under RAP and the rule against unreasonable restraints on alienation. 54 Because of their minimal impact upon alienability, nearly all classic ROFRs will satisfy the rule against unreasonable restraints on alienation. 55 But what if the ROFR is not time limited as to its exercise? One might argue that because an ROFR poses no practical impediment to alienability, RAP should not apply, and some courts have agreed. 56 Nevertheless, other courts continue to apply RAP in prophylactic fashion to invalidate non-time-limited ROFRs. 57 Others imply a reasonable time during which the preemptionee must exercise an ROFR for the right to satisfy RAP. 58

52 Feider, 699 P.2d at 804.
53 See, e.g., Drayson v. Wolff, 661 N.E.2d 486, 497 (Ill. App. Ct. 1996). Such a conclusion appears particularly justified if the preemptionee also owns adjoining land, as was the case in Feider. In such situations, exercise allows the preemptionee to consolidate ownership of the parcels, potentially enhancing their use value or development potential.
3. Covenants Not to Compete

One of the best examples of the touch and concern standard's lack of clarity involves judicial treatment of noncompetition covenants. Often, a grantor will convey fee title or a leasehold estate subject to a covenant that neither the grantee/lessee nor its successors may use the premises to compete with a business activity operated by the grantor/lessor on adjacent or nearby land. Early American courts often refused to enforce such arrangements against successors, holding that noncompetition covenants did not touch and concern land and benefitted only the business interests of the grantor. For example, in Norcross v. James, an 1885 Massachusetts Supreme Court case, the grantor, who operated quarries on adjacent lands, deeded land subject to a covenant that purported to prohibit the grantee from operating a quarry. The court held that the covenant did not touch and concern the land and did not bind the grantee's successor because the covenant "[did] not make the use or occupation of it [the grantor's land] more convenient." Instead, the covenant merely benefitted the grantor's business by excluding competition.

Over time, decisions such as Norcross received substantial and justifiable criticism. While the covenant in Norcross certainly protected the grantor's quarrying business, the grantor had made a substantial investment in developing the surrounding lands as a quarry, and the restriction, if enforceable, would have enhanced the value of that investment. For this reason, modern decisions hold that noncompetition covenants can touch and concern land, as the Massachusetts Supreme Court itself recognized in overruling Norcross in 1979. Today courts generally enforce noncompetition covenants unless they find a particular covenant constitutes an unreasonable restraint on trade or competition.

4. Tying Arrangements

Suppose that A sells Blueacre to B and delivers a deed that obligates B and B's heirs, successors, and assigns to use A's lawn maintenance services.
If this agreement is supported by consideration, A seemingly could enforce this agreement against B under contract law. But should the covenant run with title to bind B’s successor?

Traditionally, most courts applied the touch and concern principle to strike down such tying arrangements. A classic example is *Caullett v. Stanley Stilwell & Sons, Inc.*, in which a developer (Stilwell) sold an undeveloped, one-acre lot to Caullett for $4,000 by a deed under which Stilwell “reserve[d] the right to build or construct the original dwelling or building on said premises.” The covenant, by its terms, was expressly binding upon successors. When Caullett later challenged the covenant’s enforceability by claiming the covenant was impermissibly vague and did not touch and concern land, the trial court quieted title in favor of Caullett, and the Maryland Court of Appeals affirmed and characterized the covenant as too obscure to justify its enforcement. The court also concluded that even if the covenant was sufficiently definite, it did not touch and concern land:

This is at best a personal arrangement between the two parties, designed to insure defendant a profit on the erection of a dwelling in return, allegedly, for a comparatively low sales price on the land. While there is nothing in our law precluding such an arrangement, as a contract *inter partes*, this form of contract, contemplating a single personal service upon the property, does not affect the title. . . .

Generally prerequisite to a conclusion that a covenant runs with the land at law is a finding that both burdened and benefited properties exist and were intended to be so affected by the contracting parties . . . [When] the burden is placed upon the land, and the benefit is personal to one of the parties and does not extend to his or other lands, the burden is generally held not to run with the land at law. The policy is strong against hindering the alienability of one property where no corresponding enhancement accrues to surrounding lands.

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65 Id. at 53.
66 See id. at 54.
67 Id. at 55–56 (citations omitted).
The *Caullett* court acknowledged that this rule had been subject to criticism, and the criticism is justified, at least as applied to the facts in *Caullett*. While being unable to bid his construction contract would have disadvantaged Caullett by requiring him to pay a noncompetitive price, he apparently obtained the lot at a discount from its otherwise unrestricted price. In addition, enforcing the covenant would not have impacted the alienability of the land. Because the covenant was recorded, anyone buying the undeveloped lot from Caullett could have discovered the tying arrangement and lowered the offer price accordingly. Further, the covenant’s potential impact on alienability was temporary as it only provided Stilwell the right to build the first home on the lot. Once Stilwell constructed that first home, the covenant no longer would have affected title to the land or the price in later sales. Under those circumstances, applying the touch or concern rule to defeat the covenant is the proverbial equivalent of “launch[ing] a missile to kill a mouse.”

Recognizing the problems of taking a prophylactic approach, some courts have used equitable discretion to enforce comparable tying arrangements against successors. One notable example is *Chock Full of Power Gasoline Corp. v. Bill Wolf Petroleum Corp.*, in which Linmont Properties (Linmont) purchased a lot on which Newman, Nager, and Wolf (NN&W) had been operating an Amoco station. In conjunction with the sale, which was partially financed by NN&W, Linmont and NN&W agreed that Linmont and its successors would buy gasoline from NN&W or its designee for a period of ten years. Six years later, Chock Full bought the land from Linmont and refused to comply with the requirements contract. The trial court held that the agreement did not run with the land, but the appellate division reversed and noted that Chock Full purchased the premises “with full knowledge of its terms, including the covenant binding all subsequent

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68 See id. at 56.

69 This assumes that subsequent buyers have some way to determine that Stilwell actually built the home—satisfying the covenant—as uncertainty about the provenance of the home could render the title unmarketable. Presumably, the owner of the land could have obtained and recorded some acknowledgment from Stilwell that the covenant had been performed.


72 See id. at 31.

73 See id.
Concluding that the requirements contract was of a reasonable duration, the majority held the covenant to be "an equitable obligation which is enforceable against Chock Full as a taker with actual notice."75

While some courts have enforced comparable arrangements,76 many others have refused to do so. One particularly egregious example is Montgomery v. Creager,77 in which the court refused to enforce a gasoline purchase requirements contract against a successor even though the contract, by its terms, could have run against the successor for no more than one year. Thus, it only could have had a de minimis impact upon the land's alienability.78 Likewise, in Bremmeyer Excavating, Inc. v. McKenna,79 Parks entered into an agreement that granted Bremmeyer Excavating (Bremmeyer) the exclusive right to provide fill services upon certain land belonging to Parks for a period of five years. Although the agreement, with its five-year term, would have only nominally impacted the land's alienability, the Washington Court of Appeals held that the benefit of the covenant was personal to Bremmeyer and, thus, the burden of the covenant did not bind Parks's successor.80

5. Agreements to Retain Development Control

Suppose that X wants to sell a parcel of land but retain some or all of the economic benefit associated with the land's future development. X can

74 Id. The court also noted that Chock Full had originally attempted to negotiate a modification or termination of the agreement. See id.

75 Id. The decision in Chock Full of Power was 3-2, with the dissenting judges objecting that the requirements contract did not "touch or concern the land in any physical sense" and was "manifestly personal to plaintiffs' business." Id. at 32-33 (Brennan & Benjamin, JJ., dissenting).

76 See, e.g., Trosper v. Shoemaker, 227 S.W.2d 176 (Ky. 1949) (enforcing restrictive covenant); Staebler-Kempf Oil Co. v. Mac's Auto Mart, Inc., 45 N.W.2d 316 (Mich. 1951) (enforcing restrictive covenant).

77 22 S.W.2d 463 (Tex. Civ. App. 1929).

78 See id. at 466 ("The agreement . . . is certainly not such as attaches to the property, but is purely personal between Creager and Montgomery.").


80 See id. at 568–69.

This contract . . . does not impose a benefit or a burden on the property at all. It imposes a burden on Parks personally and then only with respect to his choice of a contractor to provide fill and site improvements . . . "Intent is not enough to make a running covenant out of one which is by its nature personal." Id. at 568–69 (quoting Mullendore Theatres, Inc. v. Growth Realty Investors Co., 691 P.2d 970, 972 (Wash. Ct. App. 1984))).
do this by retaining an option or first refusal right as discussed earlier in Part II. But can X do this merely by creating a covenant that runs with the land and requires X's approval for future development?

A classic example is *Garland v. Rosenshein.* Rosenshein bought a parcel of land in Peabody, Massachusetts in 1986 for $775,000. Hoping to develop this parcel together with an adjoining parcel, Rosenshein negotiated to buy the adjoining parcel. Unable to acquire that parcel, Rosenshein sold his lot in June 1987 to North Shore Auto Brokers, Inc. (North Shore) for $1.25 million subject to a covenant that purported to prohibit North Shore and its successors from developing the property in conjunction with the adjoining parcel without Rosenshein's consent. Several years later, North Shore's successors, Garland and Pantazelos, reached a development agreement with the owner of the adjoining parcel and sued Rosenshein seeking a declaration that the covenant was unenforceable under a state statute providing that a covenant is enforceable only if it "is at the time of the proceeding of actual and substantial benefit to a person claiming rights of enforcement." The Massachusetts Supreme Court upheld the trial court's judgment that the covenant did not bind Garland and Pantazelos and held the covenant provided no actual and substantial benefit:

Section 30 must refer to an "actual and substantial benefit" to the holder of a purported right of enforcement beyond the "hold-up price" for releasing the restriction. To be "actual," the benefit must come from the existence and enforceability of the restriction, rather than from the price of releasing the restriction.

The court also held that the covenant was not enforceable under common law principles, noting that Rosenshein "admittedly owns no land which is benefited by the restriction" and recognizing that "where the benefit is personal, the burden of the covenant does not run with the land." *Garland* reflects the traditional application of the touch and concern principle. But is the result sound? Rosenshein clearly believed that a "development premium" was associated with this parcel—that it would be worth more if it could be developed in conjunction with the adjacent parcel than if developed alone. Rosenshein wanted to capture some or all of this

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81 See *supra* notes 47–58 and accompanying text.
83 See *id.* at 757.
85 *Garland,* 649 N.E.2d at 758.
86 *Id.*
development premium for himself, but could not reach an agreement with the adjacent owner. He thus tried to capture this benefit by imposing a restrictive covenant on the affected parcel. In economic terms, this effort is no different from Rosenshein retaining a preemptive right to repurchase the land triggered by its future development in conjunction with the neighboring parcel. Further, as long as Rosenshein’s buyer was aware of this restriction, the buyer could have taken the restriction into account in setting the offer price for the land. So why not enforce the restriction against a successor with notice?

One argument is that the restriction constituted an unreasonable restraint upon the land’s alienability or an unreasonable disincentive to development. But that situation certainly does not appear to have occurred in Garland, at least with respect to the parcel that Rosenshein sold. The covenant did not prevent all development of the land, only its development in conjunction with the adjacent parcel. As a result, the covenant did not narrow the market unduly for buyers of Rosenshein’s land—presumably, the covenant would not discourage those willing to develop only on that parcel. Further, after Rosenshein imposed the covenant, the land promptly sold twice at progressively increasing prices before being sold at a significantly reduced price after the FDIC foreclosed on the mortgage.

The other argument is that the restriction only benefitted Garland personally and was not land-related. But, as explained earlier, one could make the same argument with regard to a purchase option or a first refusal right, which usually are land-related only in the sense that, if enforced, they permit the holder to acquire title. If land-relatedness is the key, then it is unclear why the law should tolerate repurchase options, appreciation-sharing agreements, or defeasible estates. Why allow the grantor to retain some benefit of ownership after conveying away the burdens of ownership? The answer is that we allow grantors such flexibility to encourage transacting in land, and we view that flexibility and the transactions it produces as socially useful, at least up to the point at which we can identify external costs that outweigh the benefits associated with that flexibility. As Garland

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87 One might also challenge the covenant as an unreasonable restraint based on its impact on the value or development of the neighboring parcel, but more information is necessary to evaluate the covenant’s impact in this regard.
88 See Garland, 649 N.E.2d at 757.
89 Rosenhein purchased the property for $775,000 and subsequently sold the property to North Shore for $1.25 million. North Shore resold the parcel in 1989 for $1.675 million; three years later, following a foreclosure, Garland and Pantazelos bought the parcel from the FDIC for $550,000. See id.
90 See id. at 758.
may indicate, a prophylactic touch and concern rule could overly deter owners from entering into creative transactions that would not seriously restrain the alienability of the affected land.

6. Agreements Imposing Fees Upon Future Resales

To conclude Part II’s review of how courts have applied the touch and concern standard, this Subpart discusses the closest analogues to the modern private transfer fee covenant—quarter sales and profit-sharing agreements.

   a. “Quarter Sales”

Suppose that X sells Blueacre to Y, and delivers a deed that provides that upon all future resales of Blueacre, the seller must pay 10% of the resale price to X. This type of arrangement traditionally has been called a “quarter sale.”¹ One might defend this device as a creative method by which X can finance a portion of Y’s acquisition cost. Rather than loaning Y a portion of the sale price and taking back a mortgage, X instead might choose to accept a reduced sale price and retain the right to receive a payment of 10% of all future resales. Should the law permit X to recover the 10% resale fee upon Y’s resale and all future resales by remote purchasers?

Traditionally, the answer was a resounding no. Courts routinely struck down quarter sale arrangements, particularly if the quarter sale was structured as a condition—in other words, enforceable by forfeiture upon breach

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¹ The term quarter sale derives from a particular provision of the durable lease common in early 19th century New York:

Stephen Van Rensselaer, with the assistance of Alexander Hamilton, created a “durable lease” that would bind his tenants and their heirs to the manor in perpetuity. By calling the contract an “incomplete sale,” Hamilton had devised a means to sidestep the issue of feudalism, which had been outlawed in New York State in 1787. Tenants were required to pay the patroon an annual rent of ten to twenty bushels of winter wheat per one hundred acres, “four fat fowl,” and a day’s labor with a team of horses and wagon. In addition, the tenant was to pay all taxes and use the land for agricultural purposes only, while the patroon kept all timber, mineral, and water rights, as well as the right to exploit those resources. These leases also provided that when a tenant chose to sell all or part of his farm, [the tenant] was thus required to pay a “quarter sale” or one-fourth of the sale price to the patroon in order to release the property to another individual or party. Hence, the patroon kept all the advantages of land ownership, and the tenant had all of the obligations of land improvement, road building and taxes. This was not quite the binding to the land of the old European feudal system, but it was fairly close in actual effect.

of the payment obligation.92 *DePeyster v. Michael* reflects the classic treatment.93 In 1785, James Van Rensselaer conveyed a farm parcel of about one-hundred acres to William P. Snyder in fee and reserved an annual rent of forty-eight bushels of wheat as well as the right to one-fourth of all sums arising from all future transfers of the land.94 The agreement further provided that the lessee’s subsequent transfer would be void if the lessee did not pay the appropriate sum to the lessor when due, and the lessor reserved a right to re-enter the premises upon breach of any covenant or condition.95 In 1844, DePeyster, the successor to Van Rensselaer, brought an action in ejectment against Michael, the successor to Snyder, alleging that one or more transfers had occurred without the appropriate quarter payments.96 The trial court ruled that the quarter sale provision was void and instructed the jury to render a verdict in favor of Michael.97 The Court of Appeals of New York affirmed the judgment entered upon this verdict.98 In sweeping language, the opinion struck down such percentage arrangements, regardless of the size of the percentage:

> The ownership of the fee cannot exist in one person while the ownership of the right of alienation and of its fruits, exists in a different person. . . .
> That this principle was at an early day engrafted upon the common law and applied to estates in fee . . . is not founded exclusively on principles of natural law. It rests also on grounds of great public utility and convenience; in facilitating the exchange of property; in simplifying its ownership, and in freeing it from embarrassments, which

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93 6 N.Y. 467 (1852).
94 The agreement reserved the following to Van Rensselaer:

> [O]ne equal fourth part of all the moneys owing or that might arise by or from the selling, renting, setting over, assigning, or any how disposing of the premises leased, or any part or parcel thereof, by the said lessee, his heirs, executors, administrators and assigns, and when, and as often, and every time, the same shall be sold, rented, set over, assigned or otherwise disposed of.

*Id.* at 489.
95 See *id.* at 489–90.
96 See *id.* at 468.
97 See *id.* at 470.
98 See *id.* at 509.
are injurious not only to its possessor, but to the public at large.

... If the continuance of the estate can be made to depend on the payment of a tenth, or a sixth, or a fourth part of the value of the land at every sale, it may be made to depend on the payment of nine-tenths, or the whole of the sale money. It is impossible on any known principle to say, that a condition to pay a quarter of the sale money is valid, and a condition to pay the half or any greater proportion would be void. If we affirm the validity of a condition to pay a quarter, we must affirm a condition to pay any greater amount.99

The DePeyster court justified its prophylactic approach as a matter of judicial competence and efficiency. A reasonableness approach would oblige a court to make a nuanced evaluation in every case as to whether a particular arrangement constituted an unreasonable restraint on alienation. Certainly, a provision imposing a 100% fee would negate the grantee's title and thus unreasonably restrain alienation of the affected land. By contrast, a fee of $5 might have a relatively minor practical impact upon the alienability of the land or the price at which it will trade. Unfortunately, there is no certain point at which the size of the fee tips the scales of reasonableness. As DePeyster suggested, the prophylactic approach allowed courts to avoid the difficult and arbitrary line drawing that would result under a case-by-case rule.

Courts also invalidated similar provisions that were not expressly enforceable by forfeiture. For example, in Girard v. Myers,100 Myers, a real estate agent, contracted to purchase the Pickering Farm by a contract that divided the Farm into seven parcels.101 Myers found investors to finance the purchase of each parcel and required each investor to sign an agreement that entitled Myers to 11% of the proceeds of any and all future resales of the parcel.102 The initial investors in one parcel later sold it to Girard in a transaction in which Myers received a commission. Girard later resold the parcel but refused to pay the stipulated 11% fee to Myers and argued that the fee imposed an unreasonable restraint on alienation.103 The trial court struck

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99 Id. at 493–94.
101 See id. at 680.
102 See id. at 680–81.
103 See id. at 681.
down the agreement, and the Washington Court of Appeals affirmed in a straightforward application of the touch and concern principle:

[T]he restraints imposed upon alienation by the [agreement] . . . are not reasonable or justified under the guidelines outlined in the Restatement of Property. Myers has no interest in the Girard property. The provisions in the [agreement] imposing restraints on alienation serve no purpose other than to give Myers further profits on each resale and further investment opportunities at a bargaining advantage. This does not meet the requirement that the restraint be for the purpose of protecting an interest in land or accomplishing a worthwhile purpose.  

b. One-time Resale Fees

By contrast, suppose that X sells Blueacre to Y and delivers a deed that requires Y to pay to X a 10% resale fee, but only upon the first resale by Y, not upon subsequent resales by remote buyers. The agreement states that the payment obligation will run with title to Blueacre until the buyer pays it. Y later sells the land to Z, but Y does not pay the 10% fee to X. Should the law permit X to enforce the covenant against Z or refuse to do so because the covenant does not touch and concern land?

At first blush, this arrangement appears more benign than the true quarter sale. After all, X could have sold the land to Y for its fair market value of $200,000, taking payment of $180,000 in cash and a $20,000 purchase money note and mortgage, with no question about the enforceability of the note or the mortgage. Why not allow X to sell the land for only $190,000 in cash and retain the right to 10% of the sale price upon resale by Y, as well as the risk that Y never resells the land? As between X and Y, little reason exists not to enforce this bargain. Likewise, as long as Y has recorded the covenant, one might argue that any remote buyer can either (1) obtain assurance of the covenant's prior performance or (2) discount its offer price to account for the payment obligation. Finally, because of the one-time nature of the fee covenant, it only temporarily effects alienability and the market value of the land; once the buyer pays the fee, the land will trade freely at its unrestricted fair market value. Accordingly, under a case-by-case ap-

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104 Id. at 683–84.
105 This statement presumes that remote purchasers readily can confirm the covenant's completed performance. Ideally, this confirmation would come as an affidavit or other recordable document so as to assure future title searchers of the covenant's satisfaction.
proach, one can make a reasonable case for enforcing the covenant against Z.

Consistent with this approach, some courts have upheld one-time resale fees as reasonable and enforceable restraints on alienation. In Kerley v. Nu-West, Inc., for example, the Arizona Court of Appeals upheld the enforcement of a resale fee identical to the above hypothetical (i.e., a one-time resale fee), concluding that the covenant had a worthwhile purpose (allowing the original purchaser to defer a portion of the full purchase price of the land). Likewise, in United States v. 397.51 Acres of Land, two sisters conveyed their respective undivided one-third interests to their brother, the third covenantee, by a deed that reserved for each sister the right to receive one-third of any future condemnation award over $25,000. Nearly twenty years later, the land was condemned, and the sisters sought to enforce the right to payment against the brother and his wife, collectively successors to the brother’s interest. The Tenth Circuit upheld a judgment in favor of the sisters, rejecting the view that the agreement constituted an invalid quarter sale and holding that the agreement involved “no restraint” on alienation of the land.

Nevertheless, other courts have struck down similar resale fees or profit-sharing arrangements. Some explicitly have used the rhetoric of

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106 See, e.g., United States v. 397.51 Acres of Land, 692 F.2d 688 (10th Cir. 1982); Kerley v. Nu-West, Inc., 762 P.2d 631 (Ariz. Ct. App. 1988); Application of Mazzone, 22 N.E.2d 315 (N.Y. 1939) (discussing reservation of right to payment from future condemnation award and holding that deed provision did not restrain alienation because grantor had no control or restriction on full and free conveyance of the land to successive owners; Whitemore v. Woodlawn Cemetery, 75 N.Y.S. 847 (App. Div. 1902); Bennet v. Washington Cemetery, 11 N.Y.S. 203 (Sup. Ct. 1890) (reservation of right to payment upon resale of cemetery lots; held that deed provision was valid means of enabling buyer to pay agreed purchase price of the cemetery).


108 See id. at 635–36.

109 692 F.2d 688 (10th Cir. 1982).

110 See id. at 690.

111 See id.

112 See id. at 691–92.

113 See, e.g., Caulk v. Orange County, 661 So. 2d 932 (Fla. Dist. Ct. App. 1995); Lafond v. Rumler, 574 N.W.2d 40 (Mich. Ct. App. 1997); Wiesenthal v. Young, 116 N.Y.S.2d 449 (App. Div. 1952). In another common fact pattern, donors have conveyed or devised a fee simple estate but provided that if the grantee/devisee sold the land, the grantee had to pay some or all of the proceeds to other family members. For example, in White v. White, testator devised a home but stated that if the devisee sold the home within fifteen years of the testator’s death, two-thirds of the sale proceeds would be payable to the devisee’s brother and sister. 251 A.2d 470 (N.J. Sup. Ct. Ch. Div. 1969). The court held the
touch and concern, such as in *Caulk v. Orange County*, in which grantors deeded land to Hibbard but required that any proceeds from condemnation of a portion of the land would be payable to grantors. The Florida District Court of Appeal held that the provision was a personal covenant that did not touch and concern land. Other courts instead have struck down such arrangements as violations of the rule against unreasonable restraints on alienation. For example, in *LaFond v. Rumler*, a buyer that had agreed to purchase land for $60,000 received a third-party offer to buy the land for $80,000. Because the seller needed immediate use of the buyer's down-payment, seller and buyer modified their agreement such that (1) buyer would purchase the land on an installment contract for $20,000 down and payments of $400/month and (2) seller and buyer—for themselves and their successors—would split the profit if the buyer resold during the ensuing fifteen years. In part because the agreement entitled the seller to reject a proposed resale if the price was inadequate, the Michigan Court of Appeals affirmed an order declaring the profit-sharing provision to be an unreasonable restraint on alienation. Likewise, in *Wiesenthal v. Young*, a deed restricted any transfer by the buyer/grantee for a period of two years but provided that seller/grantor could waive this restriction upon payment of $1,000. When the grantor thereafter demanded this $1,000 payment for his consent to the grantee's proposed sale, the grantee refused. The Appellate Division of the Supreme Court of New York reversed a judgment in favor of the grantor, citing *DePeyster* and holding that the provision constituted an unreasonable restraint on alienation despite its limited two-year duration.

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restriction to be an unreasonable restraint on alienation because it would "discourage improvements." Id. at 474–75; accord *Wieting v. Billinger*, 3 N.Y.S. 361 (Sup. Ct. 1888); *In re Surovy's Will*, 215 N.Y.S.2d 845 (Sur. Ct. 1961); *Dunlop v. Dunlop’s Ex’rs*, 132 S.E. 351 (Va. 1926).

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115 See id. at 933.
116 Id. at 934.
118 See id. at 41.
119 See id. at 41–42.
120 See id. at 45.
122 See id. at 450.
123 See id.
C. The Restatement of Servitudes

As explained in Part II.B, the touch and concern standard has a mixed record as a check against unwarranted interference with the alienability of land. Decisions like Caullett, Montgomery, and McKenna demonstrate that the if-the-benefit-is-in-gross-the-burden-won’t-run rule is an exceedingly blunt tool. Applying the rule in a prophylactic fashion can negate covenants that were a fundamental part of the parties’ bargained-for consideration and would have had at best a de minimis or temporary impact upon the alienability of the affected land. Further, courts have not applied the rule consistently, as reflected by the decisions involving rights of first refusal, covenants not to compete, and tying arrangements. Finally, the theory underlying the rule varies; while some courts continue to rely upon the rhetoric of touch and concern in evaluating covenants that create in gross benefits, others assess whether such covenants constitute unreasonable restraints on alienation.

For these reasons, the touch and concern standard attracted substantial criticism in the drafting of the Third Restatement. In 2000, the American Law Institute promulgated the Third Restatement in an attempt to “[t]reat[] the law of easements, profits, and covenants as an integrated body of doctrine.” The Third Restatement overtly abandons the touch and concern requirement, stating in section 3.2 that “[n]either the burden nor the benefit of a covenant is required to touch or concern land in order for the covenant to be valid as a servitude.” Adopting a strong freedom-of-contract approach to the creation of servitudes and their enforcement against successors, section 3.1 provides that a servitude is valid unless it is “illegal or unconstitutional or violates public policy” —effectively shifting the burden

125 See supra notes 50–80 and accompanying text; see also RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.2 cmt. d (2000) (discussing affirmative payment obligations and tying arrangements, stating: “The touch-or-concern doctrine does not provide the means to discriminate between those which should and should not be enforced, and leads to apparently incomprehensible distinctions in cases and to invalidation of some legitimate servitudes.”).
126 See, e.g., Caullett, 170 A.2d at 55.
128 RESTATEMENT (THIRD) OF PROP.: SERVITUDES intro. (“It is designed to allow both traditional and innovative land-development practices using servitudes without imposing artificial constraints as to form or arbitrary limitations as to substance.”).
129 Id. § 3.2.
130 See id. § 3.1.
of establishing that a covenant is invalid to the party challenging it.131 Servitudes that are invalid because they violate public policy include, but are not limited to, those that (1) are arbitrary, spiteful, or capricious; (2) unreasonably burden a fundamental constitutional right; (3) impose an unreasonable restraint on alienation; (4) impose an unreasonable restraint upon trade or competition; or (5) are unconscionable.132 While a servitude that imposes a direct restraint on alienation is enforceable only if enforcement is reasonable under the circumstances,133 a servitude that imposes only an indirect restraint on alienation is enforceable as long as a rational justification supports it.134

As with many law reform efforts, the Third Restatement has drawn both great praise and trenchant criticism. Abandoning the touch and concern requirement has not met with universal support. Commentators have long argued that retention of the touch and concern standard is justified as a check on the creation of servitudes that have nothing to do with ownership or use of land.135 As discussed in Part III, the current debate over the enforceability of private transfer fee covenants may provide an object lesson for this critical perspective.

131 See id. § 3.1 cmt. a.
132 See id. § 3.1(1)-(5).
133 See id. § 3.4 ("A servitude that imposes a direct restraint on alienation of the burdened estate is invalid if the restraint is unreasonable. Reasonableness is determined by weighing the utility of the restraint against the injurious consequences of enforcing the restraint.").
134 See id. § 3.5:

An otherwise valid servitude is valid even if it indirectly restrains alienation by limiting the use that can be made of property, by reducing the amount realizable by the owner on sale or other transfer of the property, or by otherwise reducing the value of the property. . . . [But a] servitude that lacks a rational justification is invalid.

III. SHOULD COURTS ENFORCE PRIVATE TRANSFER FEE COVENANTS UNDER THE THIRD RESTATEMENT?

Under the traditional if-the-benefit-is-in-gross-the-burden-won't-run rule, a developer had little incentive to impose private transfer fee covenants. Given their analytical similarity to quarter sales, courts were unlikely to enforce such covenants against successors. In the wake of the *Third Restatement*, however, the use of private transfer fee covenants has accelerated. The *Third Restatement* appears to have encouraged the spread of such covenants by purporting to reject the traditional prophylactic rule in favor of a reasonableness standard that presumes covenants are reasonable. Indeed, companies marketing private transfer fee covenants characterize such covenants as reasonable restraints within the meaning of the *Third Restatement*.

But is this view correct, or should the law view private transfer fee covenants as contrary to public policy and an unreasonable restraint on alienation? This Part evaluates transfer fee covenants under the rules set forth in the *Third Restatement*. It first briefly addresses transfer fees payable to HOAs and then turns to private transfer fee covenants.

A. Transfer Fees Payable to HOAs

The most common example of transfer fees payable to HOAs is the "flip tax" that cooperative documents frequently impose upon transfers of a cooperative apartment. To date, courts have upheld the ability of cooperative associations to collect transfer fees created by the cooperative's governing documents, whether the fees are structured as a fixed dollar fee, a per share fee, or a fee based on a percentage of net profit on resale. An il-

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136 See supra notes 91–104 and accompanying text.
137 See *Freehold Brochure, supra* note 8.
138 The promotional material of Freehold Capital Partners specifically points to the *Third Restatement* as support for the enforceability of its covenant device. See *Freehold Brochure, supra* note 7, at 10.
139 See infra Part III.A.
140 See infra Part III.B.
Illustrative example is *Mayerson v. 3701 Tenants Corp.*, in which the court upheld the validity of a 7.5% transfer fee and held that the transfer fee’s purposes of raising revenues needed for the cooperative’s operations and discouraging speculation were legitimate. Notably, the *Mayerson* court did not discuss whether the amount of the fee was proportionally appropriate, either to the transaction costs experienced by the association due to the transfer, or relative to the incentive to flip units. The *Mayerson* court also rejected an argument that the fee unreasonably discriminated against recent purchasers as compared to long-term residents.

Under the *Third Restatement*, transfer fee covenants payable to HOAs should be enforceable. Each of the plausible purposes for the fee covenant—funding the association’s costs of investigating and approving purchasers, promoting stability within the building, and financing the maintenance of common facilities—provides a rational justification within the meaning of section 3.5(2). Indeed, in the official comments to section 3.5, illustration 5 explicitly acknowledges the validity of such community transfer fee covenants.

B. Private Transfer Fee Covenants

1. *The Nominal Case for the Private Transfer Fee*

As discussed in Part I, the private transfer fee covenant imposes a fee that is payable to private parties and thus does not finance ongoing commu-
nity services or maintenance. As discussed earlier, under the traditional touch and concern standard, the private transfer fee covenant created an in gross benefit; therefore, its burden could not be enforced against successors. But under the rules set forth in the Third Restatement, the enforceability of the private transfer fee covenant is a bit murkier. The Third Restatement provides that “[a]n otherwise valid servitude is valid even if it indirectly restrains alienation . . . by reducing the amount realizable by the owner on sale or other transfer of the property, or by otherwise reducing the value of the property” but “[a] servitude that lacks a rational justification is invalid.” In other words, under the Third Restatement, a rational justification can overcome the fact that an indirect restraint reduces the value of the land.

Marketers of transfer fee covenants defend them as a reasonable restraint on alienation. They argue that a 1% private transfer fee covenant imposes no practical burden upon the alienability of land. They also argue that, as long as the covenant is of record, a buyer of an affected lot can reduce its offer price to account for the transfer fee obligation that the buyer will incur upon resale. Under this view, the private transfer fee covenant does not diminish the alienability of the land and only slightly reduces the price at which a transfer will take place.

Further, developers make a plausible case—or at least a case that at first blush sounds plausible—that a 1% private transfer fee covenant has a rational justification because it provides a mutual benefit to both parties, thus facilitating residential development and home ownership. The covenant benefits the developer by allowing the developer to retain transfer fee rights, which facilitate the developer’s marketing efforts. The covenant permits the developer to sell its lots at a discounted price relative to comparable unre-

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150 See supra notes 15–17 and accompanying text.
151 See Restatement (Third) of Prop.: Servitudes § 3.5 (2000).
152 See, e.g., Freehold Brochure, supra note 8, at 10 (suggesting that Freehold’s covenant satisfies the Third Restatement).
153 See id. (arguing that “[t]he mere obligation to pay money will generally not suffice to unreasonably restrain alienation because the sales price will adjust to account for the restraint”). For some, such as Richard Epstein, this statement properly ends the analysis; in his view, because notice permits the buyer to adjust, the law should place no legal limits on the ability of parties to attach promises to land as servitudes beyond those inherent in the operation of a recording statute. See Richard Epstein, Notice and Freedom of Contract in the Law of Servitudes, 55 S. Cal. L. Rev. 1353, 1368 (1982). Nevertheless, the Third Restatement requires that an indirect restraint must still have a rational justification because, as Jeff Stake has observed, Epstein’s account “takes insufficient account of the fact that people do stupid things” and thereby “reduce the well-being of society.” Stake, supra note 118, at 934.
stricted land in exchange for the delayed economic benefit of receiving future transfer fees.

The covenant also theoretically benefits the buyer; while the covenant will reduce the amount the buyer will collect upon resale, it should also reduce the buyer's acquisition cost relative to the acquisition cost for comparable unrestricted land. Reducing the buyer's acquisition cost may produce collateral savings in the buyer's carrying and transaction costs. The lower purchase price means the buyer presumably is borrowing less to finance the purchase, thus reducing the buyer's interest costs. Likewise, the premiums for the buyer's title insurance—and for the mortgagee's loan policy, which the buyer typically pays—will be marginally lower. The reduction in the land's value should also marginally reduce the buyer's ad valorem real estate tax obligations. Finally, if the buyer later resells the land using a broker, the broker's commission should be slightly lower as the covenant will produce a lower selling price relative to comparable unrestricted land.\(^{154}\)

Based on this narrative, some courts might be reluctant to invalidate a transfer fee covenant as lacking a rational justification. Indeed, the Third Restatement's freedom-of-contract rhetoric is sweeping:

Many economic arrangements for spreading the purchase price of property over time and for allocating risk and sharing profit from property development can be attacked as indirect restraints on alienation. If such arrangements are not unconscionable and do not otherwise violate public policy, there is usually no reason to deny the parties freedom of contract. The parties are usually in a better position than judges to decide the economic trade-offs that will enable a transaction to go forward and enhance their overall value. The fact that the value that may be realized from a parcel of land that is part of a larger arrangement has been reduced does not justify legal intervention to nullify part or all of the agreed-on arrangement.

... [I]ndirect restraints may have no overall negative effects on the wealth of a society overall or more narrowly, on the value of its land resources. On the contrary, they may result in an overall increase in wealth. Therefore,
[section 3.5] adopts the position that a servitude is not invalid simply because it reduces the value of a particular piece of land or reduces the amount the owner will realize on sale of the land. Unlike direct restraints . . . courts should not attempt to weigh the harm caused by an indirect restraint against the overall value of the transaction in which the servitude played a part. There are too many potential variables, and private decisionmaking is more likely than judicial decisionmaking to increase overall wealth and well-being.\textsuperscript{155}

The comments continue with the sweeping statement that "[s]ervitudes created in commercial transactions seldom lack rational justification."\textsuperscript{156}

The comments to section 3.5 also recognize, however, that "[t]he fact that there may be a rational justification for the obligation is not sufficient; there must be a rational justification for imposing the obligation as a servitude that runs with the land."\textsuperscript{157} This statement acknowledges that the servitude must create some benefit that counterbalances the negative impact enforcing the servitude will have upon the value of the burdened land.\textsuperscript{158} But with the abandonment of the touch and concern standard, the benefit need not be appurtenant to land. Thus, courts sympathetic to the freedom-of-contract rhetoric in the above-quoted comments may hesitate to undo this bargain by invalidating a transfer fee covenant as an unreasonable restraint on alienation.

Indeed, the comments to the Third Restatement equivocate on whether a transfer fee covenant creates an unreasonable restraint on alienation in violation of sections 3.1(3) and 3.5. The comments to section 3.5 validate transfer fee covenants payable to an HOA to defray community operating costs and to a charitable foundation to defray the expenses of maintaining land subject to a conservation servitude.\textsuperscript{159} Nowhere do the comments state that a private transfer fee covenant lacks a rational justification, although

\begin{footnotes}
\footnotetext[155]{\textbf{RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.5 cmt. a (2000).}}
\footnotetext[156]{\textit{Id.} cmt. b.}
\footnotetext[157]{\textit{Id.} cmt. a.}
\footnotetext[158]{\textit{See id.} ("If there is no rational justification for the servitude, it should not be enforced because there is no real trade-off for the resulting decrease in the value of the land, and the legal system should not be used to enforce irrational arrangements against unwilling participants.").}
\footnotetext[159]{\textit{See id.} cmt. c., illus. 5 (payment of transfer fee to HOA); cmt. c., illus. 7 (payment of transfer fee to maintain conserved land).}
\end{footnotes}
the drafters easily could have included such an illustration. Furthermore, illustrations in other comments may create an implication that exacerbates this uncertainty. For example, section 7.12 provides that affirmative covenants to pay money terminate after a reasonable time if the instrument creating the covenant does not specify the total sum due or a definite termination date. The comments then apply this provision to a private transfer fee covenant:

Developer imposes a covenant on all lots in the Green Acres subdivision requiring payment of one percent of the sale price on each transfer of a fee simple and one percent of the value of leases for 10 years or longer to Developer, its successors or assigns. The covenant does not specify a total sum due or a termination point. If the covenant is valid under the rules stated in Chapter 3, it terminates after a reasonable time has passed.

Read in isolation, this phrasing leaves open the possibility that a rational justification could support a private transfer fee covenant within the meaning of section 3.5.

2. Private Transfer Fee Covenants and Sound Land Policy

Notwithstanding the ostensible justifications that advocates of private transfer fee covenants offer, enforcing such covenants constitutes unsound public policy. For several important reasons, discussed in turn below, courts should refuse to enforce these covenants against successors.

a. Buyers Cannot Accurately Price the Effect of a Private Transfer Fee Covenant

The argument that a private transfer fee covenant is a reasonable restraint on alienation depends upon a dubious assumption: that a buyer can correctly evaluate the covenant’s implications and adjust his offer price to

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160 As discussed below, rather than attack private transfer fee covenants as lacking a rational justification, the Third Restatement takes the view that private transfer fee covenants are unconscionable in most circumstances. See infra notes 168–69.

161 See id. § 7.12. On its face, this section would not invalidate the Freehold private transfer fee covenant, which is by its express terms is limited to ninety-nine years in duration.

162 Id. cmt. b, illus. 1 (emphasis added).
account for its effect. But even if most buyers know a private transfer fee covenant exists, they cannot price its effect with precision.

First, the amount of a buyer's future transfer fee obligation is a function of the land's value at a future date. Both the expected future appreciation in the land's value and the appropriate discount rate—the rate used to convert the expected future transfer fee obligation into present dollars—must be taken into account. Even if we assume the buyer knows she will resell and thus incur a transfer fee in five years' time, little or no empirical data exists to support the proposition that the average homebuyer can make an informed or accurate judgment about future rates of land appreciation or discount rates. Anecdotally, the current mortgage crisis, in which millions of borrowers incurred excessive mortgage debts on the assumption that land values would continue to appreciate, raises substantial doubt about the average homebuyer's capacity to predict future land values.

Second, most buyers do not know how long they will own their homes, and they need this information to price the covenant's effect accurately. Assume that X is looking to buy a home that would have a $250,000 value if unrestricted but that is subject to a 1% private transfer fee covenant. If X plans to sell the house in two years, X can readily appreciate the need to discount the offer price to account for the fact that X expects to incur a transfer fee of around $2,500 (give or take a few dollars to account for any appreciation or depreciation in value) in two years' time. By contrast, if X expects to live in the house for forty years (for example, until X retires or dies), X may reasonably conclude that the covenant's effect in present dollars is de minimis and discount X's offer price by a much smaller amount.

163 As Thomas Merrill and Henry Smith have explained, one reason why courts traditionally limited property rights to standardized forms (the numerus clausus principle) was that standardization reduced information processing costs:

When property rights are created, third parties must expend time and resources to determine the attributes of these rights, both to avoid violating them and to acquire them from present holders. The existence of unusual property rights increases the cost of processing information about all property rights. Those creating or transferring idiosyncratic property rights cannot always be expected to take these increases in measurement costs fully into account, making them a true externality. Standardization of property rights reduces these measurement costs.


164 Suppose that X bought land in 2000 for a price of $250,000 and expected not to sell it until X's expected retirement in 2040, at which time X expected to sell it for $500,000 due to anticipated appreciation. X would expect to incur a $5,000 transfer fee in 2040, but the
But typical buyers have no idea whether they will live in their home for two years or fifty years, and thus cannot accurately judge the appropriate amount by which to discount the offer price.

Third, in most real estate negotiations, buyers lack a way to evaluate the cost savings that advocates cite to justify the enforcement of private transfer fee covenants. If a transfer fee covenant enables X to acquire Blueacre for $2,500 less—and thus to borrow $2,500 less to acquire Blueacre—X will save $100-$120 in interest costs during the first year and slightly less during each subsequent year as the principal balance amortizes. But X cannot know for certain that X is saving $100-$120 per year in interest costs unless X also knows X is paying $2,500 less to acquire the land due to the presence of the covenant. Unfortunately, X cannot be confident of this unless the developer offers X the choice of buying the land at either a restricted price (subject to the covenant) or an unrestricted price (not subject to the covenant). If the developer presents the covenant to X on a take-it-or-leave-it basis, X does not have a meaningful covenant or no covenant choice. Further, because land is relatively unique, a buyer cannot easily identify an identical or even similar unrestricted parcel to use as a baseline to calculate the incremental burden and benefit of the covenant.

On the whole, buyers are likely to underestimate the covenant's effect and, thus, are unlikely to discount their offer prices sufficiently.\(^\text{165}\) To the extent this is true, private transfer fee covenants effectively operate as an arbitrage opportunity for the developer. Not surprisingly, the promotional materials used by Freehold to market its transfer fee covenant documentation tout this opportunity. Freehold's brochure suggests that a 1% transfer present value of that fee in year-2000 dollars would be only about $486, assuming a discount rate of 6%.

People frequently make decisions using mental shortcuts or biases that make transactions and decisions easier, but this type of decision making can lead to erroneous judgments. See Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974). One such shortcut is a bias toward optimism: during decision making, people may tend to overestimate the likelihood of favorable future events (for example, a buyer may assume that he will live in the house for longer than is likely). See Anat Bracha & Donald J. Brown, *Affective Decision Making: A Theory of Optimism Bias*, in COWLES FOUNDATION FOR RESEARCH IN ECONOMICS (YALE UNIV. 2010). Another such bias is the ambiguity effect, which may cause a buyer to ignore the impact of information that the buyer does not have or that is too difficult for the buyer to process. In addition, the effect heuristic might cause a buyer to ignore or discount certain information (for example, the economic impact of a transfer fee covenant) based upon the buyer's positive affect toward the potential house purchase (for example, "I really love that kitchen.").
fee covenant should reduce the buyer’s offer price by approximately 2%. At the same time, earlier versions of Freehold’s brochure estimated the present value of the future stream of transfer fee payments at approximately 5% of the improved value of the property. If buyers truly were informed and sufficiently sophisticated to price the covenant accurately, such a sizable gap should not be present.

In fairness to Professor Susan French, the reporter for the Third Restatement, she likewise doubted the ability of most residential purchasers to price a private transfer fee covenant accurately. The Third Restatement addresses the problem not through section 3.5—in other words, not as an unreasonable restraint on alienation—but through section 3.7, which provides that “[a] servitude is invalid if it is unconscionable.” Illustration 3 in the commentary to section 3.7 suggests that a court should treat a private transfer fee covenant as unconscionable:

The declaration of covenants for Greenacres, a residential subdivision, includes a provision obligating the owner of each lot to pay the developer, or its assigns, a royalty of one percent of the gross sales price on each resale of each lot in the subdivision in perpetuity. In the absence of unusual circumstances, the conclusion would be justified that the provision is unconscionable.

While I agree that private transfer fee covenants should not be enforceable, I doubt the conclusion in the quoted illustration is descriptively correct, at least based upon existing unconscionability doctrine. First, no reported cases exist in which a court has invalidated a private transfer fee covenant as unconscionable or consistently invalidated analogous covenants as unconscionable. Second, considering existing case law on unconsciona-

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166 See Freehold Brochure, supra note 8, at 3.
167 See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.7 cmt. c (2000).

"The fact that the performance called for by one party extends far into the future and its value cannot be readily predicted at the time the servitude is created is [a] factor that may lead to the conclusion that a servitude is unconscionable . . . . The average buyer may not appreciate the long-term significance of the servitude arrangements because the physical characteristics of the housing and the quality of the neighborhood are likely to occupy the forefront of the buyer’s attention."

168 Id. § 3.7.
169 Id. cmt. c, illus. 3.
bility, courts likely will not consistently strike down private transfer fee covenants as unconscionable.

A court will invalidate a contract as unconscionable only if the contract is both procedurally and substantively unconscionable. Procedural unconscionability focuses upon the relative bargaining power between the parties and the extent to which the contract clearly discloses its terms. A buyer seeking to avoid the enforcement of a private transfer fee covenant may argue that the covenant is the product of adhesion and thus procedurally unconscionable. Some authority to this effect is present in California judicial decisions invalidating mandatory consumer arbitration agreements as procedurally unconscionable if the drafter offered them on a take-it-or-leave-it basis. Nothing about a transfer fee covenant is inherently procedurally unconscionable, however, particularly if the covenant is recorded and appears in text no smaller than any other covenants affecting the land.

Further, even if a developer refuses to negotiate over the inclusion or terms of a private transfer fee covenant, this situation is not analogous to mandatory consumer arbitration or other adhesion clauses in standard-form consumer contracting. Prospective buyers of real estate subject to private transfer fee covenants have a large supply of alternative parcels that are not subject to such covenants; therefore, a buyer that purchases land subject to such a covenant cannot meaningfully argue “I had no choice.” As a result, courts like-

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170 WILLIAM H. LAWRENCE & WILLIAM H. HENNING, UNDERSTANDING SALES AND LEASES OF GOODS 113 (1999). Courts have recognized something of a sliding scale in making this determination. While courts require both substantive and procedural unconscionability, as the substantive oppression reflected in the agreement increases, the amount of procedural unconscionability needed to invalidate the agreement decreases. See Nagrampa v. MailCoups, Inc., 469 F.3d 1257, 1284 (9th Cir. 2006); JAMES J. WHITE & ROBERT S. SUMMERS, PRINCIPLES OF SALES LAW § 5-7, at 273-275 (2009).

171 See id. at 1284 (arbitration agreement procedurally unconscionable, even if only minimally so, where one party “had overwhelming bargaining power, drafted the contract, and presented it to [the other party] on a take-it-or-leave-it basis”); see also Aral v. EarthLink, Inc., 36 Cal. Rptr. 3d 229, 238 (Ct. App. 2005) (finding “quintessential procedural unconscionability” where “the terms of the [arbitration] agreement were presented on a ‘take it or leave it’ basis . . . with no opportunity to opt out”); Flores v. Transamerica HomeFirst, Inc., 113 Cal. Rptr. 2d 376, 381 (Ct. App. 2001) (standards for procedural unconscionability are satisfied by finding that arbitration provision was presented on a take-it-or-leave-it basis and was oppressive due to “an inequality of bargaining power that result[ed] in no real negotiation and an absence of meaningful choice”).

ly will not consistently characterize private transfer fee covenants as procedurally unconscionable.

Even if one assumes that a private transfer fee covenant is procedurally unconscionable, a court is unlikely to strike down the covenant unless the covenant is also substantively unconscionable. A covenant is considered substantively unconscionable if the terms of the agreement are "so one-sided as to shock the conscience" or the bargain was "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other." The Third Restatement clearly views the private transfer fee as unconscionable based upon its cumulative effect: "Even if the burden on any single owner of the burdened land is not unduly harsh, the cumulative effect of a requirement for perpetual payments by all future owners may be regarded as oppressive."

Again, however, case law on unconscionability does not indicate that courts will systematically invalidate private transfer fees as unconscionable. Courts tend to apply unconscionability on an ad hoc basis, evaluating the formation of the particular agreement, the terms of the agreement, and the relative bargaining power and sophistication of the parties. Thus, one would expect unconscionability to produce mixed results: courts might enforce some fee covenants, but not others, depending upon the size of the fee, how conspicuously the covenant appears in the document, and the sophistication level of the buyer. Further, unconscionability is also unlikely to produce consistent results because judges substantially differ in their philosophical disposition toward freedom of contract. Instead, sound land policy and equitable treatment of homebuyers requires the consistent nonenforcement of private transfer fee covenants.

b. Private Transfer Fee Covenants Substantially and Unjustifiably Impair the Alienability of Affected Land

Private transfer fee covenants have a significant potential to impede future land transactions by imposing additional and unwarranted transaction costs. Taken collectively, these costs, which could take a variety of different forms highlighted below, might exceed any ostensible savings in transaction and carrying costs touted by advocates of private transfer fees.  

173 Circuit City Stores, Inc. v. Mantor, 335 F.3d 1101, 1107 (9th Cir. 2003) (quoting Ingle v. Circuit City Stores, Inc., 328 F.3d 1165, 1172 (9th Cir. 2003)) (internal quotation marks omitted).
174 RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.7 cmt. a (2000).
175 Id. cmt. c.
176 See supra notes 152–54 and accompanying text.
Investigation and escrow costs. Developers sometimes sell their right to collect future transfer fees. If the developer has sold the transfer fee rights, a seller required to pay a transfer fee may incur expenses to locate and pay the holder of the transfer fee rights. If the seller cannot find the holder, the seller may be unable to close without agreeing to escrow the transfer fee—to address satisfactorily the risk of a potential lien for unpaid transfer fees—until the seller can locate the holder.\(^\text{177}\)

Negotiation and compliance costs. Most private transfer fee covenants nominally obligate the seller to pay the transfer fee, but the seller actually does not bear the effective cost of the fee. As in most real estate transactions, the parties negotiate a price that effectively apportions the various closing costs or not-yet-payable real estate taxes. A private transfer fee covenant adds one more variable to that negotiation and potentially makes the negotiation longer and more complex. In addition, the seller may incur cost in determining whether the seller must disclose the presence of the covenant and, if so, in making proper disclosure.\(^\text{178}\)

In addition, because most private transfer fee covenants purport to create a lien to secure unpaid fees, a question arises: what are the relative priorities of a lien to secure unpaid transfer fees and a mortgage taken and recorded after the transfer fee covenant is recorded? Any mortgage lender financing the purchase will expect to have a first priority lien. While the lender can obtain some protection by directing payment of the transfer fee

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\(^{177}\) In its transfer fee covenant documentation, Freehold attempts to ameliorate this risk by designating a trustee to collect transfer fees as they accrue. See Freehold Brochure, supra note 8, at 5, 11, & 15. The trustee keeps track of the holder of the transfer fee rights over time, and as fees are paid, disburses those fees to the then-holder of the rights. See id. In this respect, one might characterize the trustee as a servicer of the transfer fee rights. Theoretically, this structure ameliorates or moots the investigation cost problem by enabling each seller to satisfy the transfer fee obligation by paying the trustee. Nevertheless, the identity of the trustee could change over time, requiring the seller to incur the cost of identifying the new trustee.

\(^{178}\) Traditionally, the seller did not have a duty to disclose title matters prior to contracting but had a duty to deliver a marketable title at closing. See Stoebuck & Whitman, supra note 1, § 10.12, at 775. Although courts have required home sellers to disclose material defects in the condition of the home that would not be discovered in a reasonable inspection, see, e.g., Katherine A. Pancak, Thomas J. Miceli & C.F. Sirmans, Residential Disclosure Laws: The Further Demise of Caveat Emptor, 24 Real Est. L.J. 291, 293 (1996), this duty does not appear to cover a title matter, which the seller could presumably discover in a title search. Nevertheless, a broker representing the seller may insist that the seller disclose the covenant, fearing that otherwise the buyer may use the subsequent discovery of the covenant as a means to refuse to perform based upon title being unmarketable. See supra note 10.
from the loan proceeds, the lender may lack evidence of payment of transfer fees that arose in prior sale transactions. Thus, the lender financing the purchase of land that is subject to a private transfer fee covenant will likely require the holder of the transfer fee covenant to subordinate its lien—requiring the parties to incur the cost associated with negotiating, preparing, and recording a subordination agreement. Likewise, the buyer may incur additional time and expense negotiating with the title insurer over the form of the exception that the insurer will take for the presence of the covenant and the risk that transfer fees from prior sale transactions remain unpaid.

(3) **Multiple Transfer Fees?** Finally, if private transfer fees are enforceable and reasonable in theory, nothing prevents an owner of land from imposing an additional transfer fee covenant benefitting that owner. A buyer might see this as a way to recapture the cost of the initial transfer fee through fees levied upon future resales. Such a “stacking” of transfer fee covenants would result in the payment of multiple fees upon future resales. This approach exacerbates the transaction costs described above and magnifies the covenant’s practical effect upon the land’s value and thus its future alienability.

**c. Private Transfer Fee Covenants Reduce the Tax Base for the Benefit of Private Parties**

Finally, and most importantly, the financial benefit that a private transfer fee covenant creates for the developer comes at the public’s expense. To the extent that a private transfer fee covenant is enforceable against successors, it reduces the value of the affected land. This reduction artificially decreases the ad valorem tax base of the broader public community of which

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179 Freehold’s transfer fee covenant documentation mitigates the lien priority problem by expressly subordinating its lien to the lien of a lender financing the purchase. See *Freehold Brochure*, supra note 8, at 15. This approach negates the need to obtain a subordination agreement from the trustee when financing or refinancing the purchase of an affected home. Nevertheless, the presence of the transfer fee covenant and the lien to secure unpaid fees still could violate the provisions of a mortgage or security agreement, which would necessitate the expense of obtaining the necessary consents.

180 Freehold’s transfer fee documentation purports to address this concern by prohibiting the stacking of transfer fees. *See id.* (“Our Instrument prohibits stacking of multiple fees.”). But such a restriction constrains the ability of future owners to alienate their interest as they see fit. Accordingly, the enforceability of a “no-stacking” provision is not self-evident. If developers can sell land and impose a 1% private transfer fee covenant, how can the developer legally impose an absolute prohibition on the buyer’s ability to do the same thing? Why wouldn’t such a prohibition constitute an unreasonable restraint upon the buyer’s right of alienation?
the affected land is a part.\textsuperscript{181} Incremental sums that would have funded public goods in the local community—such as public education, policing, fire protection, streets, sewers, and other community services—instead are diverted into the pockets of private developers. Furthermore, this situation happens not by a public vote, but by private contract. Sound public policy cannot and should not permit private action, taken outside the community’s democratic processes, to divert the tax base for private benefit.

As the use of private transfer fee covenants has grown, more organized efforts have begun to restrain the further spread of this practice. In October 2009, the Joint Editorial Board for Uniform Real Property Acts (JEBURPA) unanimously resolved that private transfer fee covenants are contrary to public policy and constitute an unreasonable restraint on the alienability of land.\textsuperscript{182} Likewise, both the National Association of Realtors (NAR) and the American Land Title Association (ALTA) have adopted policy statements against the use and enforcement of private transfer fee covenants.\textsuperscript{183} Most

\textsuperscript{181} Theoretically, the municipality could account for this reduction by treating the transfer fee right itself as a taxable interest in real property and taxing that interest. Doing so, however, presents some profound practical obstacles. The existing real estate tax system is parcel-based, and because the value of a transfer fee right is typically a percentage of the value of the underlying parcel, the municipality would have to value a developer’s transfer fee rights on a parcel-by-parcel basis. However, the amount of the tax on such a small fractional share may not be worth the additional record keeping expense for the tax collector. Further, would the tax on the transfer fee right be payable each year (i.e., based upon the assessed value of the transfer fee right) or only as parties sell property and pay fees? Because of these practical concerns, the municipal ad valorem tax system likely would not capture the appropriate portion of transfer fee rights.

\textsuperscript{182} JEBURPA serves as a consultative group to advise the Uniform Law Commission regarding potential subjects for uniform laws pertaining to real estate. JEBURPA is comprised of representatives from the Uniform Law Commission; the ABA’s Real Property, Trust and Estate Law Section; the American College of Real Estate Lawyers; and liaison members from the American College of Mortgage Attorneys and the Community Associations Institute. In April 2010, JEBURPA approved and issued a position paper expressing the view that state courts should not enforce private transfer fee covenants and state legislatures should enact statutes expressly prohibiting their enforcement. Joint Editorial Board for Uniform Real Property Acts, \textit{Position Paper on Private Transfer Fee Covenants} (April 2010), www.law.missouri.edu/freyermuth/JEBURPA/JEBpositionpaperprivatetransferfeecovenants.pdf (last visited Nov. 24, 2010).

\textsuperscript{183} ALTA’s statement provides that “[t]hese covenants provide no benefit to consumers or the public, but rather cost consumers money, complicate the safe, efficient and legal transfer of real estate, and depress home prices.” American Land Title Association, \textit{Private Transfer Fee Covenants}, www.alta.org/advocacy/docs/PrivateTransferFeeCovenant_OnePager.pdf (last visited Aug. 4, 2010). The NAR’s statement argues that “such fees decrease affordability, serve no public purpose, and provide no benefit to property purchasers, or the
recently, in August 2010, the Federal Housing Finance Agency issued proposed guidance that would (if adopted) restrict Fannie Mae and Freddie Mac from purchasing mortgages secured by land affected by a private transfer fee covenant.\textsuperscript{184}

\section*{IV. 	extbf{REINSTITUTING A PROPHYLACTIC RULE}}

Ideally, our land system should provide grantors with the flexibility to structure land transactions as they see fit, provided such transactions are not contrary to public policy and do not create unreasonable restraints upon alienability. As explained in Part III, sound land policy justifies a conclusion that private transfer fee covenants are contrary to public policy and should not run with the land as servitudes. The question of how best to reach this conclusion in our current legal system remains.

As the old saying goes, there is more than one way to skin a cat. The traditional touch and concern standard reflected the common law's cautious, over-restrictive approach to regulating land transactions. The common law recognized a limited set of permissible rights and, under the \textit{numerus clausus} principle, brooked little creativity.\textsuperscript{185} Restrictive common law rules, such as RAP and the touch and concern standard, placed prophylactic if perhaps overbroad limits upon the creativity of owners so as to protect the alienability of land in a broad sense. It was thought better, under this approach, for courts to be overprotective of alienability. Where this approach proved unsatisfactory—where it invalidated a benign practice, a wealth-maximizing practice, or both—legislatures stepped in and adjusted the sys-

\textsuperscript{184}\textit{Proposed Guidance on Private Transfer Fee Covenants}, Federal Housing Finance Agency (No. 2010-N-11), 75 Fed. Reg. 49932. Unfortunately, the proposed guidance failed to distinguish between private transfer fees and transfer fees payable to HOAs; under the proposed guidance, Fannie Mae and Freddie Mac would be unable to purchase any mortgage secured by land affected by a transfer fee covenant benefiting an HOA. Because state law has traditionally treated such fees as enforceable, see \textit{supra} notes 141–49, the proposed guidance was widely perceived as overreaching. Furthermore, because the proposed guidance would apply retroactively, its implementation would immediately render unmarketable the title of any landowner within an HOA benefited by a transfer fee covenant (as the buyer of such a title would be unable to secure conventional mortgage financing). Based upon such concerns, FHFA received over 2,600 comments, and as of the date of publication of this article, FHFA has not yet issued official guidance.

\textsuperscript{185}\textit{See} Merrill & Smith, \textit{supra} note 163, at 9–24.
tem by expressly authorizing the practice at issue.186 Examples include legislative modification of RAP187 and statutory authorization of both conservation easements188 and environmental covenants189 (rights not recognized under traditional common law rules).

The Third Restatement approached cat skinning differently. Rather than relying upon the legislature as the system's corrective device, the Third Restatement threw aside the touch and concern principle, confident that courts can and will strike the appropriate balance between the alienability of land and flexibility and innovation in land transactions. The risk of this approach is that it produces less certain results, at least in the short run; some practices that are not benign will sneak through the net until judicial consensus arises or legislatures act to rein in those practices. The recent increase in the use of private transfer fee covenants is a case in point. By rejecting the touch and concern standard, the Third Restatement created uncertainty about the enforceability of private transfer fee covenants and developers have actively exploited that uncertainty.

Too much time will likely pass before judicial consensus on the enforceability of private transfer fee covenants develops,190 and the more time

186 See id. at 58–60 (noting that nearly all changes in forms of property ownership in English and American law have occurred through legislative action).
187 See STOEBUCK & WHITMAN, supra note 1, §§ 3.21, 3.22, at 132–38 (discussing statutory RAP reforms such as the Uniform Statutory Rule Against Perpetuities, as well as the abolition of RAP either generally or as applied to interests created in trust).
188 See UNIF. CONSERVATION EASEMENT ACT, 12 U.L.A. 165 (2008 & Supp. 2010). States adopting the UCEA statutorily validated conservation easements despite the common law's traditional unwillingness to recognize new forms of negative easements. See id. at § 4 cmt. (“Because a far wider range of negative burdens than those recognized at common law might be imposed by conservation or preservation easements, [UCEA § 4(4)] modifies the common law by eliminating the defense that a conservation or preservation easement imposes a 'novel' negative burden.”).
189 See UNIF. ENVTL. COVENANTS ACT, 13 pt. 1 U.L.A. 35 (Supp. 2010). An environmental covenant facilitates the cleanup of contaminated land by specifying by covenant that cleanup can occur to a level appropriate for a particular use rather than to the level appropriate for unrestricted use. See UECA, Prefatory Note. Performance of cleanup responsibilities pursuant to an environmental covenant would involve performance of affirmative obligations on the covenantor, or its successor, and could benefit persons other than the owner of the contaminated parcel or adjacent parcels. To encourage site-appropriate remediation of contaminated sites, the UECA provides that an environmental covenant is valid and enforceable even though it involves the performance of affirmative obligations and without regard to whether it touches and concerns land. See id. at § 5(b)(5)–(6).
190 As discussed in Part III, some courts may disagree over the proper standard for evaluating a private transfer fee covenant (the traditional touch and concern rule or the Third Restatement's approach). More significantly, the relatively small size of any one transfer fee
that passes, the more land that developers can subject to private transfer fee covenants. While Representative Maxine Waters has introduced a bill in Congress that would ban the enforcement of private transfer fees, action on this bill is unlikely. Further, it is unclear whether Congress should aggressively seek to displace the traditional role that states have played in regulating the enforcement of covenants running with land.

At this point, state legislatures should step in and enact prophylactic rules providing that private transfer fee covenants are contrary to public policy and cannot run with title to land as servitudes. A number of state legislatures have already done so. Florida adopted a statute invalidating private transfer fee covenants in 2007, and Missouri followed in 2008. Beginning in 2009, an ad hoc task group comprised of representatives from ALTA and the NAR prepared a model statute, a copy of which appears in the Appendix following this article. Since 2009, an additional fourteen states—Arizona, Delaware, Hawaii, Illinois, Iowa, Kansas, Louisiana, Maryland, Minnesota, Mississippi, North Carolina, Ohio, Oregon, and Utah—have adopted statutory provisions that are substantively comparable to the ALTA/NAR model. Likewise, Texas has enacted a statute that, if properly interpreted, should ban the enforcement of private transfer fee covenants. Hopefully, legislatures in the remaining states will act promptly during the 2010-2011 legislative session to adopt comparable legislation.

makes it less likely that any particular seller will invest the attorney fees necessary to bring suit challenging the enforceability of the covenant. See generally Merrill & Smith, supra note 163, at 58 (“For a variety of reasons, legislated changes in property forms produce information to third parties at less cost than judicially mandated changes.”).

191 See Homeowner Equity Protection Act of 2010, H.R. 6260, 111th Cong., 2d Sess. The bill has been referred to the House Committee on Financial Services, but further action on the bill is unlikely.


196 The Texas statute prohibits the enforcement of a covenant imposing a transfer fee upon a “transferee of residential real property or the transferee’s heirs, successors, or assigns
The model statute prepared by ALTA and NAR expresses state legislative findings that private transfer fee covenants violate public policy by creating an unreasonable impediment to the alienability of land regardless of the duration of the covenant or the amount of the transfer fee. The statute would prospectively invalidate any transfer fee covenant recorded after the statute’s effective date, and make such a covenant unenforceable against the real property or any subsequent owner of the property. The statute would also invalidate any lien to the extent it purports to secure the payment of a transfer fee.

By its terms, the model statute would not apply to private transfer fee covenants recorded prior to the statute’s effective date. However, the statute also provides that courts should not interpret it to validate such covenants. Thus, in any state adopting the model statute, a court facing a challenge to a preexisting transfer fee covenant should evaluate the covenant’s enforceability based upon the common law of covenants and servitudes...

... in connection with a future transfer of the property.” TEX. PROP. CODE ANN. § 5.017(b) (2007). Advocates of private transfer fees have argued that the Texas statute permits enforcement as long as the covenant only obligates the transferor/seller to pay the fee. Texas courts, however, should reject this argument. Even if a buyer/transferee is not legally obligated to pay the fee that accrues when she buys the land, the covenant still imposes on her the obligation to pay “a fee in connection with a future transfer of the property”—her future resale. In addition, if the seller fails to pay the fee, it becomes a lien against the land that effectively forces the buyer to pay the fee before the buyer can deliver clear title to a subsequent purchaser.

At this point, California is the only state that has adopted a statute expressly validating the imposition and enforcement of private transfer fee covenants. The California Civil Code adopts a disclosure model, providing that a transfer fee covenant is enforceable against successors as long as the person imposing the covenant records a document indicating “Payment of Transfer Fee Required” in the chain of title to the real estate. See CAL. CIV. CODE § 1098.5 (2007). This document must contain certain mandated information, including: (1) a clear statement of the amount or percentage of the fee; (2) for residential real estate, “actual dollar-cost examples of the fee” for a home priced at $250,000, $500,000, and $750,000; (3) the expiration date of the transfer fee covenant, if any; (4) the purpose for which the funds from the fee will be used; and (5) the name of the entity to which the fee must be paid (along with specific contact information). See id.

See MODEL PRIVATE TRANSFER FEE COVENANT STATUTE § 1(b)(2) (2010). In this regard, the model statute reflects the desire to avoid the difficult line-drawing problems highlighted by the court in DePeyster in striking down the quarter sale. See supra notes 91–99 and accompanying text.

See id. § 1(c).

See id.

See id. § 1(d).
tudes. That court ought to conclude that such a covenant does not run with the land to bind successors. 202

The model statute recognizes that a covenant might impose a transfer fee that is payable to an HOA for the purpose of financing association operations, maintenance of common amenities, or both. Such covenants would typically satisfy the common law’s touch and concern test, 203 and thus the statute excludes such covenants from the definition of a “transfer fee covenant.” 204 Likewise, in master planned communities, transfer fee covenants on land within the various common interest communities that comprise the larger development may finance some amenities such as community centers, recreational facilities, or performing arts centers. Because such facilities provide an ostensible benefit to common interest communities and the owners within these communities, covenants that create transfer fees to fund those amenities are likewise excluded from coverage under the model statute. 205

V. CONCLUSION

While advocates argue that private transfer fees are reasonable and benefit buyers as well as developers, their arguments are unpersuasive. Among the previously mentioned reasons for invalidating these fees, private transfer fee covenants create an unjustified impediment to the transfer of affected real estate; further, enforcing private transfer fee covenants—and thereby lowering the value of the affected real estate—permits a developer to divert a portion of the community’s ad valorem tax base to the developer’s private benefit outside the community’s democratic processes. As a result, courts should refuse to enforce private transfer fee covenants against successors, and any states that have not done so should enact legislation consistent with the model statute discussed above and make clear that private transfer fee covenants are contrary to public policy and void.

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202 Model section 1(b)(1) makes a legislative finding that public policy favors the alienability of land “free from covenants or servitudes that do not touch and concern” the land. Id. § 1(b)(1). Absent an intervening statute or decision abolishing the touch and concern standard, a court might interpret this finding as a legislative affirmation of the touch and concern standard.

203 See supra notes 3, 141–45 and accompanying text.

204 MODEL PRIVATE TRANSFER FEE COVENANT STATUTE § 1(b)(1).

205 See id.
SECTION 1. Prohibition on Transfer Fee Covenants.

(a) As used in this section:

(1) “Association” means a nonprofit, mandatory membership organization comprised of owners of homes, condominiums, cooperatives, manufactured homes, or any interest in real property, created pursuant to a declaration, covenant, or other applicable law.

(2) “Transfer” means the sale, gift, grant, conveyance, assignment, inheritance, or other transfer of an interest in real property located in this State.

(3) “Transfer fee” means a fee or charge imposed by a transfer fee covenant, but shall not include any tax, assessment, fee or charge imposed by a governmental authority pursuant to applicable laws, ordinances, or regulations.

(4) “Transfer fee covenant” means a provision in a document, whether recorded or not and however denominated, which purports to run with the land or bind current owners or successors in title to specified real property located in this State, and which obligates a transferee or transferor of all or part of the property to pay a fee or charge to a third person upon transfer of an interest in all or part of the property, or in consideration for permitting any such transfer. The term “transfer fee covenant” shall not include:

(A) any provision of a purchase contract, option, mortgage, security agreement, real property listing agreement, or other agreement which obligates one party to the agreement to pay the other, as full or partial consideration for the agreement or for a waiver of rights under the agreement, an amount determined by the agreement, if that amount:

(i) is payable on a one-time basis only upon the next transfer of an interest in the specified real property and, once paid, shall not bind successors in title to the property;

(ii) constitutes a loan assumption or similar fee charged by a lender holding a lien on the property; or
(iii) constitutes a fee or commission paid to a licensed real estate broker for brokerage services rendered in connection with the transfer of the property for which the fee or commission is paid;

(B) any provision in a deed, memorandum, or other document recorded for the purpose of providing record notice of an agreement described in subsection (a)(4)(A);

(C) any provision of a document requiring payment of a fee or charge to an association to be used exclusively for purposes authorized in the document, as long as no portion of the fee is required to be passed through to a third party designated or identifiable by description in the document or another document referenced therein; or

(D) any provision of a document requiring payment of a fee or charge to an organization described in Section 501(c)(3) or 501(c)(4) of the Internal Revenue Code, to be used exclusively to support cultural, educational, charitable, recreational, environmental, conservation, or other similar activities benefiting the real property affected by the provision or the community of which the property is a part.

(b) The Legislature makes the following findings:

(1) The public policy of this State favors the transferability of interests in real property free from unreasonable restraints on alienation and covenants or servitudes that do not touch and concern the property.

(2) A transfer fee covenant violates this public policy by impairing the marketability of title to the affected real property and constitutes an unreasonable restraint on alienation, regardless of the duration of the covenant or the amount of the transfer fee set forth in the covenant.

(c) A transfer fee covenant recorded after the effective date of this section, or any lien to the extent that it purports to secure the payment of a transfer fee, is not binding on or enforceable against the affected real property or any subsequent owner, purchaser, or mortgagee of any interest in the property.

(d) Nothing in this section shall imply that a transfer fee covenant recorded prior to the effective date of this section is valid or enforceable.