February 18, 2016

Running With the Land

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A long-honored concept in real property, that of "covenants running with the land," is finding its way into the bankruptcy courts. If a covenant (a promise) runs with the land then it burdens or benefits particular real property and will be binding on the successor owner; if that covenant does not run with the land then it is personal and binds those who promised but does not impose itself on a successor owner. In some cases, bankruptcy courts are now holding that preexisting contracts containing covenants running with the land cannot be rejected and that such covenants will be binding on the bankruptcy estate.

While options have not fared well and are often rejected, the analogous preferential purchase right or right of first refusal may survive especially if contained in a contract earlier in the chain of title (but also applicable in the case of current contracts), under the notion that the bankrupt's title must be taken as it existed at the filing and the estate takes its property rights subject to any conditions or burdens existing thereon. Though there is precedent that preferential rights are executory contracts subject to rejection, the more recent trend is that rights created by state law in specific assets are not avoidable by rejection (debtors wanted to sell real property to a local telecom but many of the lots were subject to a right of first refusal – held that the pref right was not executory and that Section 365(a) was not an avoiding power that repudiates cancels or terminates a pref right. *In re Bergt*).

Likewise a burden imposed on a transportation agreement may survive. In the *Energytec* case, Newco held an interest in a transportation fee to be paid by the producer based on the amount of gas flowing through the pipeline. The producer went bankrupt and tried to sell the asset free and clear of Newco's interest in the transportation fee. The 5th Circuit used an analysis of the burden as a covenant running with the land to find that Newco's interest would continue in the hands of the purchaser out of bankruptcy.

Most recently, Bankruptcy Judge Shelley Chapman, who is presiding over the Sabine bankruptcy announced that she was "inclined" to rule that the gathering agreements Sabine had entered into with various gatherers do not contain covenants running with the land and could, therefore, be rejected. Generally it is thought that gas gathering agreements containing dedications of specific acreage are covenants running with the land so, given the lack of an opinion from Judge Chapman, it is difficult to determine why Sabine's contracts might be different.

Texas law on covenants running with the land has been addressed in the relatively recent past. In the *Westland* case, the Texas Supreme Court was faced with an area of mutual interest agreement which was not of record but the agreement containing the AMI was referenced by another document in the chain of title. Finding that the AMI agreement was binding on successors, and noting that the rule originated in England in 1583, the court laid out the following requirements:

1. The covenant must be binding on assigns;

2. The covenant must "touch and concern" the land;

3. Privity of estate must exist between the parties to the covenant; and

4. The parties must intend the promise to run with the land. This requirement also yields the requirement that successors must have notice of the obligation.

Generally, the most problematic issue is whether it touches and concerns the land. Courts have avoided describing the analysis needed to reach a conclusion; it seems the courts "know it when they see it" and have added to the definition: the covenant must be beneficial or burdensome to the owner of the estate as owner of the estate or performance or nonperformance must affect the nature, quality, or value of the property independent of collateral circumstances. Some examples may be useful.

An easement grant to a railroad contained a requirement to build a fence if the tracks crossed grantor's land: held to run with the land.

An irrigation district agreed to build an irrigation channel for land surrounding a canal purchased from Biggs. A grantee from Biggs sought to enforce the covenant: held to run with the land since the benefit came only to the owners of the land.

A supply contract for natural gas to run irrigation pumps for a certain tract of land: held to run with the land.

A filling station proprietor agreed to buy all of its gasoline from C. The station was sold and the new owner decided to guy gasoline elsewhere; C sued to enforce the promise: held the contract was personal to the original owner and did not run with the land.

The take away is that if your contracts meet the four tests of *Westland* then there is a significant chance that your agreement may avoid one of the most pernicious effects of bankruptcy on third parties – rejection of your contract.

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