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Covenants Running with the Land - Union Trust Company v. Rosenburg

Casenotes and Comments

COVENANTS RUNNING WITH THE LAND—*UNION TRUST COMPANY V. ROSENBURG*[1]

The owners of fee simple property executed a first mortgage to Rosenburg, et al., plaintiffs in this suit, containing the following covenant: "It is covenanted that until default . . . the said mortgagors, their heirs, *successors or assigns*[2] shall have possession of the property upon paying in the meantime all taxes . . . which taxes . . . the said mortgagors covenant to pay when legally due." Subsequently the said mortgagors executed a second mortgage to the Union Trust Company, defendant in this suit. In 1932 the defendant acquired the equity of redemption of the said mortgagors by foreclosure of this second mortgage, and immediately entered into possession. In 1933 default was made in the payment of interest under the first mortgage, and a verbal agreement was entered into between the plaintiffs, holders of the first mortgage, and the defendant, under which the defendant was permitted to retain possession of the premises, collect the rents, pay all expenses including taxes, and pay whatever surplus remained to the plaintiffs as interest. Pursuant to this agreement the defendant remained in possession of the premises and collected all rents and profits until foreclosure by plaintiffs of their mortgage on February 16, 1935. During the time that this verbal agreement was in effect, the defendant failed to pay the taxes for the years of 1934 and 1935. Under an agreed statement of facts, it is shown that between 1932, when defendant took possession, and February 16, 1935, when plaintiffs' foreclosed their mortgage, the disbursements by defendant for expenses, taxes, and interest exceeded the income to the extent of over $3,000, although during the fiscal year of 1934 the income exceeded the disbursements by almost $1,300, no taxes and interest being paid during that year. The plaintiffs have paid the taxes for the years 1934 and 1935, totalling over $1,800, and have brought this suit in equity for reimbursement, on the theory that defendant, as an assignee of the equity of redemption during the time at which these taxes became due, is liable on the covenant to pay them when "legally due". The

[1] 189 Atl. 421 (Md. 1937).
[2] Italics supplied.

defendant's defense is based upon two contentions: (1) That under the verbal agreement whereby defendant retained possession after default in 1933, the plaintiffs are estopped from enforcing this covenant to pay the taxes as against defendant. (2) That this covenant is a personal covenant and not a covenant running with the land because: (a) the "assigns" of the covenantors are not expressly designated and (b) affirmative burdens of covenants running with the land will only run in the cases of leasehold estates and not in the case of fee simple property. The trial court held for the plaintiffs and on appeal *held,* affirmed.

The Court devoted the major part of its opinion to the discussion of this second contention and reached the conclusion that the burden of this covenant did attach and run with the equity of redemption, originally vested in the mortgagors and subsequently involuntarily assigned to the defendant by its foreclosure of the second mortgage. Thus the equity of redemption, to which was attached the burden of this covenant, rested in defendant until February 16, 1935. The Court found that the taxes for 1934 and 1935 became "legally due" upon January first of each year, and thus the failure of defendant to pay them on those dates constituted a breach by defendant of the burden of this covenant.

As free alienability of estates in real property developed in England, a need arose for a device whereby subsequent owners of these estates could be held contractually liable for the performance or nonperformance of acts affecting the use and enjoyment of these estates. The existing concepts of profits and easements were insufficient to meet this need. These are incorporeal interests in the land itself, but in no way impose any contractual obligations upon the subsequent owners of the land. The owner of servient land subject to an easement or profit is under no contractual obligations to the dominent owner. True, his estate in the land is restricted to the extent of this easement or profit, but the servient land owner is in no manner contractually obligated to perform any act. Thus easements and profits must be limited to: (a) those which give to the dominent owner a right to a use or enjoyment of the servient land concurrently with the servient owner, or (b) those in which the use or enjoyment of the servient land by the servient landowner is restricted. But in neither is the servient landowner contractually obligated. Thus easements and

profits can impose no affirmative duties, contractual or otherwise, upon the servient land.[3]

This need could only be satisfied by developing the concept of a real contract, that is, a contract which was not only personal to the contracting parties, but which also would attach to the land and run with the land and bind and benefit subsequent assignees of the land. The first early English cases, developing this doctrine of real contracts, were cases involving covenants between landlords and tenants, relating to the use and enjoyment of the leased land. These early cases, principally *Spencers' case*[4] laid down three requirements for a covenant to run with the land: (1) "privity of estate" must exist between the covenantor and convenantee, (2) the benefit and burden of the covenant must "touch and concern" the respective estates of the covenantee and covenantor, and (3) if the covenant relates to a thing not in esse then the covenant can only run if the "assigns" are expressly designated.

With reference to the first requirement of privity of estate, no difficulty arises in the leasehold estate cases, since there exists between the lessor and lessee a continuing relationship of tenure. Each owns an estate in the same tract of land, the lessee's being possessory and the lessor's reversionary. Because of this tenure relationship, there can be said to exist a continuing privity of estate between the lessor and lessee. Therefore if the lessee assigns his possessory estate, and the lessor assigns the reversion, there still exists between these assignees a tenure relationship. Thus clearly privity of estate exists between two assignees,[5] although they have at no time contracted with each other. The privity of contract created by the covenants in the lease exists only between the original lessor and original lessee. But the privity of estate arising from the tenure relationship has passed from the original lessor and lessee to these assignees. Thus contractual liability upon the covenants in the lease exists between these assignees so long as the privity of estate continues to exist between them.

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[3] In England and in a few American states a "spurious" easement to maintain a fence has been recognized. Bonson v. Coffin, 108 Mass. 175 (1871).

[4] 5 Coke 16a (1583).

[5] Prior to the Statute of 32 Henry VIII, Ch. 34 covenants could only run with the lessee's possessory estate and not with the lessor's reversion. This Statute made it possible for covenants to run with the reversion either as to the benefit or burden. This Statute is part of the common law of Maryland, I Alexander's British Statutes 335.

When the practice of inserting covenants in conveyances in fee developed, considerable difficulty was experienced by the courts in applying this concept of privity of estate to such conveyances in fee. Here we do not have a continuing tenure relationship arising from the concurrent existence of estates in the same tract of land, but we have, at the most, merely an instantaneous privity of estate existing momentarily on the execution and delivery of the deed. In other words the privity of estate is not a continuing one arising from a tenure relationship, but an instantaneous one existing at the moment of the transfer of the estate from the grantor to the grantee.

The courts were then presented by the problem can such a privity of estate suffice to create covenants running with the land? Two states held no, placing the doctrine of covenants running with the land upon the existence of a continuing privity of estate created by tenure.[6] The majority reached the conclusion that the existence of this instantaneous privity of estate between grantor and grantee, existing at the execution and delivery of the deed, is a sufficient foundation upon which covenants running with the land can be created.[7] Thus the covenant can be made to attach to and run with the estate of the grantee so as to bind or benefit the subsequent assignee of this estate. But what about the covenant on the part of the grantor? He no longer holds an estate in the land which was the subject-matter of the conveyance. The covenant on his part may be in gross, or if the intention of the parties can be shown it may be attached to other land which he then owns, and thus run with such land so as to bind or benefit the subsequent assignee of such land.[8]

As to the third requirement that if the covenant relates to something not in esse, then the assigns must be expressly designated, a controversy has developed as to soundness of this requirement. Some question has been raised whether the English courts ever laid down this requirement, or it was merely the personal idea of Lord Coke.[9] Several jurisdictions have entirely repudiated this requirement.[10]

[6] 19 Pick. 449 (Mass. 1837); 68 P. 308 (Calif. 1902).

[7] At least one jurisdiction has reached the conclusion that no privity of estate is necessary between the covenantor and covenantee (grantor and grantee), Shaber v. St. Paul Water Co., 30 Minn. 179, 14 N. W. 874 (1874). Under this view the only privity of estate necessary is that between the covenantor and his assigns or that between the covenantee and his assigns.

[8] Ball v. Milliken, 31 R. I. 36, 76 Atl. 789 (1910).

[9] Purvis v. Shuman, 273 Ill. 286, 112 N. E. 679 (1916).

[10] Ibid.

Probably the majority of jurisdictions today hold that the assigns do not have to be expressly designated if the intention that the covenant should run with the land can be inferred from the language of the entire instrument.[11]

Applying these principles to the facts of this case, the Court found that the first mortgage, from the original mortgagors to the plaintiffs, created a privity of estate between the original mortgagors and plaintiffs, such that covenants inserted in the mortgage might attach to their respective estates and run therewith. It is interesting to note that the privity of estate, arising in the execution of a mortgage, is not of the instantaneous type found in conveyances in fee, but of a continuing nature similar to that existing between landlord and tenant. A mortgage of fee simple property has the effect of passing to the mortgagee the fee simple title as security only, thus leaving in the mortgagor an equitable estate described as the equity of redemption. Thus as long as the equity of redemption remains unbarred by foreclosure, a continuing privity of estate exists between the mortgagor and mortgage. The burdens and benefits of any covenants running with the land, found in the mortgage, attach to these estates of the mortgagor and mortgagee so as to run with such estates to their respective assigns. So in this case the burden of this covenant to pay the taxes when legally due attached to the equity of redemption and ran with such equity of redemption until it was barred by the foreclosure on February 16, 1935. Likewise the benefit of this covenant attached to the plaintiffs' fee simple security title and would run with it to any assignee of the mortgage.

When in 1933 the defendant foreclosed its second mortgage and purchased this equity of redemption, it acquired the equity of redemption subject to the burden of this covenant. Thus from 1933 until February 16, 1935, the defendant held the estate, i. e. the equity of redemption, to which the burden of this covenant was attached, and therefore became contractually liable for any breach occurring during this period.

Defendant in its brief took the position that where a covenant creates an affirmative burden rather than a restrictive one, the affirmative burden could not run with the land except in cases of leases. It is true that the English courts as well as one American state uphold the position that affirmative burdens are in gross when created in a con-

[11] Masury v. Southworth, 9 Ohio St. 340 (1859).

veyance in fee rather than a lease.[12] But the majority of American jurisdictions have upheld the running of affirmative burdens as well as restrictive burdens whether found in conveyances in fee or leases.[13] Likewise it should be noted that this covenant is found in a mortgage which is more nearly similar to a lease than a conveyance in fee, since it creates a continuing privity of estate rather than an instantaneous privity only.[14]

One of the principal points discussed by the Court in its opinion was whether the burden of this covenant to pay the taxes so touched and concerned the original mortgagors' equity of redemption, that it was capable of running with this estate to the defendant. In this connection defendant contended that a distinction must be made between the burden of a covenant to pay taxes by a lessee under a lease, and a burden of a similar covenant by a mortgagor under a mortgage on fee simple property. Why doesn't the nonperformance of such a covenant affect the mortgagor's equity of redemption as much as the lessee's leasehold estate? In either case nonperformance may operate to destroy the estates through a sale of the land to pay delinquent taxes. A covenant is said to touch and concern the land when "it tends directly or necessarily to enhance its value or render it more beneficial and convenient to those by whom it is owned or occupied."[15] Certainly any covenant, the nonperformance of which destroys the estates of both the covenantor and the covenantee, touches and concerns the land, so that both the burden and benefit will run with their respective estates. *Waring v. National Saving & Trust Co.*[16] is definite authority for the Court's position that the burden of a covenant to pay taxes in a mortgage on fee simple property touches and concerns the equity of redemption so that it can run with that estate.

The most bothersome problem in this case involves the third requirement of covenants running with the land, namely that if the covenant relates to something not in esse, it will not run unless the assigns are expressly designated. Here the covenant relates to taxes which were not in esse when the mortgage was executed. The taxes for

[12] Miller v. Clary, 210 N. Y. 127, 103 N. E. 1114 (1913).
[13] Murphy v. Kerr, 5 F. (2d) 908 (1925). See 41 A. L. R. 1363 for a list of cases.
[14] However, Guaranty Trust Co. v. N. Y. & Q. C. R. Co., 253 N. Y. 190, 170 N. E. 887 (1930) refused to hold that an affirmative burden could run with the mortgagor's estate when created in the mortgage.
[15] Hollander v. Central Metal Co., 109 Md. 131, 71 Atl. 442 (1908).
[16] 138 Md. 367, 114 Atl. 56 (1921).

1934 and 1935 were clearly not in esse when this covenant was executed. A careful inspection of the covenant discloses that in the covenanting clause, the assigns of the mortgagor are not expressly designated. However, in the clause giving the mortgagors the right to possession until default upon payment of taxes, this right is expressly given to the "assigns". Thus from the wording of the entire instrument an intention to bind the mortgagors' assigns can be inferred although the covenant proper does not bind the assigns by express designation.

The opinion, without discussion of earlier Maryland decisions, finds that an intention to bind the assigns can be inferred from the language of the entire instrument, thus taking the view, supported by the weight of authority today, that the word "assigns" is not a technical word, necessary to the running of a covenant relating to something not in esse. This conclusion is contrary to the position taken in *Maryland & Pennsylvania R. Co. v. Silver*,[17] where it was held that "his heirs and assigns" were technical words of limitation and in cases of covenants relating to something not in esse were absolutely necessary in the covenanting clause. The refusal of the court to follow this strict interpretation of *Spencer's case*[18] is to be commended, and places Maryland among those states taking a liberal view of this discredited requirement of covenants running with the land.

With reference to the first contention the Court reached the conclusion that the verbal agreement was not supported by any new consideration and therefore in no way operated to change the legal rights and liabilities of the parties, and at most merely operated as a voluntary postponement by plaintiff of foreclosure. Even though the agreement had no validity and effect as a contractual modification of the original covenant in the first mortgage, yet it might operate to estop the plaintiff from enforcing this covenant if pursuant to this verbal agreement defendant acted in reliance thereon to its detriment. True, the doctrine of estoppel cannot be applied as a substitute for consideration, for many decisions have repudiated the existence of a "promissory estoppel".[19] Thus the existence of an estoppel cannot be used to validate the verbal agreement made between

[17] 110 Md. 510, 73 Atl. 297 (1909).

[18] Supra note 4.

[19] Williston on Contracts, (Rev. Ed.) Sec. 139, note 8. The Restatement of Contracts, Sec. 88, approves the application of "promissory estoppel" in certain cases.

plaintiff and defendant. But estoppel can be raised as a basis of an abandonment of an existing contract right.[20] The benefit of this covenant appearing in the first mortgage, rested in plaintiffs at the time of this verbal agreement. This benefit is a contract right capable of abandonment, and therefore if the defendant can show a change of position or detriment suffered by reliance upon this verbal agreement, it has raised an estoppel against the enforcement of this benefit. However, did the defendant suffer a detriment or make a change of position in reliance on this verbal agreement by retaining possession until February 16, 1935?

In *Williams v. Safe Deposit & Trust Co.*,[21] the Court of Appeals held that under our title theory of mortgages, where the mortgage contains a provision reserving the right of possession in the mortgagor until default, the privity of estate remains in the mortgagor until default, and then on default immediately passes to the mortgagee although the latter has not entered into actual possession. On the basis of this case defendant could have abandoned possession of the premises in 1933 at the time of the default, and successfully contended that its privity of estate had automatically passed to the plaintiffs on default. Without privity of estate remaining in the defendant there could be no liability for future breaches of this covenant during 1934 and 1935. Thus the defendant, by verbally agreeing to remain in possession as mortgagor after default, and thus in effect consenting to retain its privity of estate, did act to its detriment and change its position so as to be entitled to the benefit of the doctrine of estoppel. Plaintiffs' only basis of recovery for breach of this covenant during 1934 and 1935 is that there existed privity of estate in the defendant. Thus if defendant could have automatically transferred this privity of estate to plaintiffs by its default in 1933, it changed its own position by consenting to retain possession in the capacity of mortgagor and thus retaining the privity of estate which is the essential basis for liability under this covenant during 1934 and 1935.

It is therefore submitted that the Court might have upheld defendant's first contention that this verbal agreement estopped the plaintiffs from enforcing the covenant after the default in 1933. In this connection it must be noted that during 1934 the defendant had a sufficient sur-

[20] Williston on Contracts, (Rev. Ed.) Sec. 139, note 13.
[21] 167 Md. 499, 175 Atl. 331 (1934).

plus of income over disbursements to have paid that year's taxes, and therefore has failed to comply with the express provisions of this verbal agreement. Instead defendant used this surplus to reimburse itself for loss arising in the operation of the premises before this verbal agreement was entered into. However, as for the taxes for 1935 no surplus of income over disbursements existed during the month and a half of the year of 1935 that defendant retained possession, so any liability for nonpayment of that year's taxes must be predicated upon the covenant in the first mortgage.

Having reached the conclusion that the burden of this covenant did run with the equity of redemption to the defendant, so as to render it liable for breach of the covenant by nonpayment of the taxes for the years of 1934 and 1935, there remained the final problem of whether plaintiffs' cause of action was enforcible in equity. The defendant's estate in the property terminated on February 16, 1935, thereby terminating its privity of estate with plaintiffs, and terminating any liability for breaches subsequent to that date. However, as to its liability for breaches occurring before February 16, 1935, this was not affected by the termination of this privity of estate. Yet, as plaintiffs had not instituted suit upon these breaches while the privity of estate continued to exist, the Court, following the decision of *Donelson v. Polk*,[22] held that plaintiffs had lost their remedy at law and must maintain their suit in equity.

This position rests upon the mistaken view that privity of estate is a necessary element to an action at law against an assignee of the covenantor. Privity of estate is necessary at the time of the breach, so as to attach the covenant to the land and thus render the assignee, who holds the privity of the estate at the time of the breach, liable; but when the breach has occurred, a cause of action exists between the parties then holding the benefit and burden. Such a cause of action is personal between the parties, and is entirely divorced from the land. Subsequent transfers of the burdened estate or of the benefitted estate in no way affect this cause of action. In other words, privity of estate must exist at the time of the breach, but is not essential at the time of the suit. Here defendant held the burdened estate at the time of the breaches, thus creating a personal cause of action for damages vested in plaintiffs against defendant. The fact that defendant's estate and privity

[22] 64 Md. 501, 2 Atl. 824 (1886).

of estate terminated on February 16, 1935 should be immaterial to the maintenance of this cause of action.

It is unfortunate that our Court of Appeals has blindly followed its early decision in *Hintze v. Thomas*[23] upon this point, since the decision in that case was based upon dictum in the early English case of *Fogg v. Dobie.*[24] Now, the interesting feature of this dictum is the fact that it is contrary to the explicit decision, after full argument, in the earlier English case of *Harley v. King.*[25] At the present time Maryland is the sole jurisdiction which still follows this mistaken dictum of this early English case.[26] Our Court of Appeals could do much in clarifying the doctrine of privity of estate, if it would recognize its mistake, and expressly hold that privity of estate is only essential at the time of the breach as a means of fixing the contractual liability upon the assignee, but that once such liability arises the continuance of such privity of estate is nonessential to the maintenance of an action at law upon this personal cause of action.

[23] 7 Md. 346 (1855).
[24] 3 Younge C. Ch. 96, 160 Eng. Rep. 629 (1838).
[25] 2 Cromp. M. & R. 18, 150 Eng. Rep. 8 (1835).
[26] See for a full discussion Tiffany's Landlord and Tenant, Sec. 158 (dd), particularly note 480 for a discussion of the Maryland decisions.