

Restraints on Alienation

Take-Away: When real estate interests are transferred at death, it is important to keep in mind the common law rule that prohibits *restraints on alienation*.

Background: The common law tells us that paramount to the success of an estate plan is testamentary freedom, which means the right and ability to leave one's property to whomever one wants, and however one wants, and subject to whatever conditions one may wish to impose. However, that is not a completely accurate statement. There are some long-standing limitations to testamentary freedom.

Rule Against Perpetuities: Periodically the topic of the Rule Against Perpetuities comes up in estate planning as one such limitation to an individual's testamentary freedom. [Michigan's 90- year Uniform Statutory Rule Against Perpetuities, MCL 554.71 et seq.] Or, more accurately, the estate plan exploits the reality that the Rule Against Perpetuities is no longer much of an impediment to a trust's duration, which explains the growing popularity of dynasty-type trusts to avoid estate and GST taxes over multiple generations. [Michigan's 360-year Personal Property Trust Perpetuities Act, MCL 554.93 et seq.]

Restraint on Alienation: Sometimes the Rule Against Perpetuities is confused with the so-called rule dealing with the Suspension of the Power of Alienation. This less discussed rule is the common law prohibition on the unreasonable alienation restraints pertaining to real estate. This other limit on testamentary freedom can suddenly appear to invalidate clauses in deeds, Wills, and Trusts that restrict the real property owner's right to freely transfer their property interest. As a generalization, an absolute prohibition on the transfer/sale of real estate, called a *disabling restraint*, is void as against public policy. Less clear are partial restraints on alienation, i.e., the ability to transfer, due to factors like price, purpose, or duration, all of which are tied to a presiding court's view of what is a *reasonable* restriction or restraint.

Common Law: The common law disfavors any limitation placed on the ability to transfer real estate. The purpose of this principle is to encourage the free use and development of real property. A clear example of the restraint on alienation is a restriction that accompanies the deed that restricts the new titleholder's ability to transfer their real

property. This restriction might appear in the form of a forfeiture provision if a transfer is attempted, or a covenant that accompanies the title that is used as a condition subsequent leading to a breach of contract action where the titleholder promises not to transfer the real property. This restriction on alienation will cause an otherwise valid deed to be void, retroactively, since condition/limitation is an attempt to impose contractual liability for breach of contract. Or such a restraint can come in the form of a forfeiture of the property interest conveyed.

Michigan Statute: The Real and Personal Property Act, Chapter 554 of the Revised Michigan Statutes of 1846 (yes, it goes that far back in time) generally provides that the absolute power of alienation should be suspended for no longer than two lives in being at the time the property interest is created. [MCL 554.381.]

Michigan Court Decisions: The first judicial recognition of this common law principle was the Michigan Supreme Court decision *Mandlebaum v. McDonnell*, 29 Mich 78 (1874) where the Court announced a ‘firm stance against restraints on alienation.’ Almost eighty years later the Court renewed this view when it invalidated a deed which ‘restricts the number of potential buyers.’ *Braun v. Klug*, 335 Mich 691 (1953.) However, there are also several Michigan Court of Appeals decisions where other ‘partial’ restraints on transfers of real estate were upheld by the court, as reflected in the fairly recent *In re Estate of Virgil F. Hoppert*, Michigan Court of Appeals, No. 362694, June 29, 2023, where a Restriction Agreement, which described the specific terms of the parties to exercise a purchase option at the other parties’ death, was found by the court to *not* be an unreasonable restraint since the length of the Agreement’s expiration date was not unreasonable, nor did the Agreement ‘give rise to too many options.’

At best, Michigan’s common law rule that prohibits restraints on alienation applies a judicial test of *reasonableness* which, sad to say, is not much of a standard to follow for those who draft Wills and Trusts, or those who administer trusts on behalf of their clients who want to limit how devised real estate will be held and used by their beneficiaries.

Reasonableness: A review of court decisions regarding the restraint on alienation that limit testamentary freedom seems to suggest that a judge will look to purpose, duration and scope of the limitation that is imposed. Restraints that appear as either a flat

prohibition on the sale of the real estate or impose a forfeiture if there is an attempted conveyance, or the titleholder's promise, usually in the form of a covenant that accompanies the deed to not sell the property, are usually highly suspect. Partial restraints can also appear in rights of first refusal, a land conservation agreement, or any other type of restrictive covenant that 'runs with the deed.'

Factors: In evaluating whether a restriction or restraint is *reasonable* courts will often look to the following factors:

- (i) whether the parties have equal bargaining power, which is probably non-existent if the restricted real property passes by Will or Trust.
- (ii) whether the restraint clearly defines the limitations on alienation.
- (iii) whether a specific time limit or duration is placed on the restraint.
- (iv) whether the price is fixed, or non-fixed (courts prefer non-fixed.)
- (v) whether the restraint makes the real property interest more valuable.
- (vi) whether the restraint is limited to a small number of persons.
- (vii) whether the restraint contradicts the fundamental rights associated with the real property.
- (viii) whether the restraint has a legitimate purpose (though *legitimate* is about as vague as *reasonable*.)

Material Purpose Provision: Identifying the purpose for the restraint on alienation might be a good practice to follow if a trust instrument is used to effectuate a transfer of real estate encumbered with the restriction. The settlor could describe the restraint as a *material purpose* of his/her trust and provide their reasoning for its inclusion in the trust's dispositive provisions. Probate courts are required under the Michigan Trust Code to pay close attention to, and reluctant to modify, a trust instrument if the modification is contrary to the settlor's *material purpose* as expressed in their trust.

Examples: A few examples where a court was forced to consider terms of a deed or estate planning instrument as a restraint on alienation follow.

Example-Sale Limited: The homeowner created a trust that directed the trustee to transfer the title to her home to her three children after her death. However, the deed to her children provided that the children could not sell the real property to anyone except their siblings, and also that the amount of the specified purchase price a child was to receive was to be well below their property interest's fair market value. The court held that this prohibition was an unreasonable restraint on alienation and void because it severely limited the class of potential buyers for the real estate while it denied the children the fair market value of their interests. *Godoy v. Linzer*, 327 Cal. Reporter, 3d 323 (2024). The California Court of Appeals noted that "there is a very strong presumption of invalidity of restraints on fee simple interests."

Example- Easement to Landlocked Parcel: A court will generally grant an easement by necessity when the property owner severs his/her land and leaves a parcel without access to a public road, i.e., landlocked. The easement will allow passage over land that had been connected to the landlocked parcel before it became landlocked. This reflects the common law principle that a landowner is not allowed to create land to which there is no access. However, some courts will allow a parcel to remain landlocked if that was the owner's implied intent; the reasoning behind this 'default' rule is that the owner of the landlocked parcel can always give or sell their parcel to a neighbor or a buyer could purchase both the landlocked parcel and the land next to it that adjoins a public road. In *Acorn Development LLC v. Sanson Co*, Ohio Court of Appeals, 2022 WL 2979808 (2022) the Court opted for the default rule, holding that an easement contained in a 90-year lease terminated when the lease ended.

Example- Possibility of Reverter: The Virginia Court of Appeals held that a future interest that required the forfeiture of title if property was not used for church purposes was a valid possibility of reverter and therefore it was not an invalid or unreasonable restraint on alienation of land, noting that a liberal interpretation should be given to deeds that involved land given for charitable purposes because limiting property to charitable uses is consistent with public policy. *Canova Land & Inv. Co. v Lynn*, Virginia Court of Appeals, 856 S.E.2d 581 (2021).

Example- Permanent Right of Refusal: In *DiSchino v Delanson Circle Holding, Massachusetts. Superior Court*, LEXIS 67 (2018) the court held that permanent rights of refusal applying to tenants-in-common interests were void as unreasonable restraints on

alienation. The Court noted that a right of first refusal is not an unreasonable if it is not for a fixed price or a long period. In this case, however, the rights of first refusal owned by co-owners existed in perpetuity- the permanency of the restraint on alienation would effectively last forever, even if the co-tenant's interest was sold or transferred to another co-tenant.

Conclusion: *A restraint on alienation* usually appears when a residence, farm, cottage, or vacation home is transferred on death to family members, often in the form of an imposed tenant-in-common agreement, options to purchase, or rights of first refusal. If the imposed restraints are too 'tight' there is a good chance a court will not enforce those limitations. This possibility is something that clients need to be made aware of by their advisors when they exercise their *cold hand of the dead* right to conveying interests in real estate.

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