MICHIGAN REAL PROPERTY REVIEW

Vol. 32, No. 4 Winter 2004

CONTENTS

Published by the
Real Property Law Section
State Bar of Michigan

SEVERED MINERALS: RESTRICTIVE COVENANTS AS RESTRICTIONS ON SURFACE USE BY THE MINERAL OWNER

by Susan Hlywa Topp*

I. INTRODUCTION

The prolific development of gas and oil in northern Michigan has caused much hardship to property owners and spawned litigation over surface rights. When the mineral estate is severed from the surface estate, the development of the mineral estate creates conflict between the surface estate owner and developer of the minerals. This article addresses the impact of restrictive covenants upon the mineral owner's right to use the surface estate in the development of the minerals. The cases of *Janice Terrien, Thomas Hagan and Janet Thomas v Laurel Zwit, et al.*, 467 Mich 56, 59; 648 NW2d 602 (2002), and *The Mable Cleary Trust v The Edward Marlah Muzyl Trust*, 262 Mich.App. 485, — N.W.2d ——, 2004 WL 1366029 (Mich.App. Jun 17, 2004) (No. 244744), are discussed in detail as part of this analysis. This article will not address the issue of damages, which this author has already addressed in a previous article.[1]

II. THE DOMINANT MINERAL ESTATE

There are numerous principles pertaining to severed mineral interests that are settled law in Michigan and are incorporated into the analysis in this article: 1) oil and gas mineral interests are part of the realty until such time as they are severed therefrom;[2] 2) the ownership of the mineral interests can be severed from the ownership of the surface estate;[3] 3) the severance of mineral interests from the remainder of the land may be effectuated by a reservation or exception in the deed of conveyance;[4] 4) upon the severance of title to the mineral interest from the remaining land, the mineral estate and the surface estate each become freehold estates in fee simple and are subject to laws of descent, devise, and conveyance;[5] and 5) the owner of the severed mineral interests may lease the interests. Under an oil and gas lease, the lessee acquires the right to use and occupy that portion of the surface of the land that is reasonably needed for the exploration of oil and gas.[6]

The principles outlined above make it clear that the owner of the mineral estate has the implied right to use the surface of the property to develop the minerals. However, this right is not unfettered. The courts have held that the severed mineral owner's use of the surface estate must be reasonable, and must "accommodate" the surface owner.[7]

The implied right of access or implied easement for the severed mineral owner's use of the surface estate is dominant over the servient surface estate. This is true even when the property is subdivided into lots subsequent to the severance of the mineral estate. The California Court of Appeals rendered such a decision in *F. Glade Wall et al v Shell Oil Company et al*.[8] That court held that the mineral interest owners may exercise their rights in development of the minerals "unaffected and unlimited by divisions of surface ownership within" their leasehold estates.[9] In that case, the minerals had been severed from the surface in 1864. Subsequent to that time, the surface estate was subdivided and conveyed to others. The subsequent purchasers acquired the property with knowledge of the severed minerals. The issue for the trial court was whether the rights of the mineral interest owner could be restricted as a result of the subdivision of the property and conveyance of the smaller parcels to others. The court held that:

> Each subsequent purchaser of a subdivision thereof, taking with notice of the prior sale and reservation of rights, takes knowing that his surface ownership may be burdened in part, and, in very rare cases perhaps, in its totality, by the reasonable exercise of the rights of the owner of the oil and mineral estate; and this without regard to whether or not the oil or mineral underlies the particular subdivision, or whether the facilities located thereon serve facilities located without the subdivision.[10]

* Susan Hlywa Topp is the principal of Topp Law PLC in Gaylord, Michigan and focuses her practice on environmental, natural resource, real estate development and gas/oil matters. She is a 1978 *cum laude* graduate of Wayne University Law School. Before going into the practice of law, she was employed for 12 years as an Environmental Conservation Officer with the Michigan Department of Natural Resources.

The court further held that the mineral interest owner could use any part of the surface estate in connection with the placement of facilities required to exercise his development rights and that subsequent subdivisions created on the surface could "no wise restrict his placement of such facilities to service oil operations relating to that portion of his oil and mineral estate underlying each individual subdivision."[11]

The *F. Glade Wall* case involved land that was subdivided after the mineral estate had been severed from the surface. But what happens when there are restrictive covenants encumbering the surface estate prior to the severance of the mineral estate? This situation creates two competing easements encumbering the surface estate: the implied easement for the benefit of the mineral owner and the restrictive easement for the benefit of the property owners. In this scenario, is the severed mineral owner's right to use the surface estate subject to the restrictive covenants?

III. THE LAW OF RESTRICTIVE COVENANTS

To analyze this issue, we must review real property law on restrictive covenants. The Michigan Supreme Court has held that restrictive covenants constitute a right in every lot owner in the nature of a negative easement on every other lot in the development.[12] A restrictive covenant is an interest in real property in the nature of an easement that runs with the land.[13] It is an easement passing its benefits and its obligations to all purchasers of the land, subject to its affirmative or negative mandates.[14] A restrictive covenant is a reciprocal negative easement that is a retained incorporeal right in the land conveyed by the grantor, which lessens that "bundle of rights" normally attached to land conveyed to a grantee.[15] The extent to which an easement burdens the servient estate is determined by the words the parties use to create the easement.[16] Restrictive covenants are to be strictly construed against those creating them.[17]

In particular, the courts have strictly construed restrictive covenants that limit the use of the property to residential purposes. The Michigan Supreme Court has emphasized that the enforcement of restrictive covenants by persons who purchase property in a subdivision where the use of the property is limited to residential purposes is a valuable property right.[18] Restrictions limiting use to residential purposes prohibit non-residential use of the land subject to them.[19] Even interval ownership of condominiums has been found to violate restrictions limiting property use to residential purposes.[20]

The recent Michigan Supreme Court decision in *Janice Terrien, Thomas Hagan and Janet Thomas v Laurel Zwit, et al.*, further emphasizes the prohibition of commercial uses within subdivisions restricted to residential purposes.[21] In the *Terrien* case, the court held that a covenant barring any commercial or business enterprise is broader in scope than a covenant permitting only residential uses. The court further found that such covenants do not violate Michigan public policy and are enforceable.[22] Not only did the defendants in the *Terrien* case covenant not to use their property for non-residential uses, but they also covenanted not to use their property for commercial, industrial or business uses. The restriction on commercial or business uses proscribes activities that, although perhaps residential in nature, are commercial, industrial or business in nature as well.[23]

"Commercial" is commonly defined as "able or likely to yield a profit." "Commercial use" is defined in legal parlance as "use in connection with or for furtherance of a profit-making enterprise." "Commercial activity" is defined in legal parlance as "any type of business or activity which is carried on for a profit." "Business" is commonly defined as a "person engaged in a service" and in legal parlance as "an activity or enterprise for gain, benefit, advantage or livelihood."[24] Therefore, in its broad sense, commercial activity includes any type of business or activity that is carried on for a profit.[25]

The *Terrien* court found that the operation of a family day care home was a commercial use and such operations subtracted from the general plan of a private, noncommercial resort area that was originally intended.[26] The restrictive covenants were a strong and emphatic statement of the restriction's intent to prohibit any type of commercial or business use of the properties.[27] The *Terrien* court emphasized that "[t]his all comes down to the well-understood proposition that a breach of a covenant, no matter how minor and no matter how *de minimus* the damages, can be the subject of enforcement. As this Court said in *Oosterhouse v Brummel*, 343 Mich 283, 72 N.W.2d 6 (1955), 'If the construction of the instrument be clear and the breach clear, then it is not a question of damage, but the mere circumstance of the breach of the covenant affords sufficient ground for the Court to interfere by injunction."[28]

The *Terrien* court also found that enforcement of covenants prohibiting commercial activity does not violate public policy. Even though the activity sought to be restricted, (the operation of the family day care home) was permitted by law that did not mean that private covenants barring business activities were contrary to

public policy.[29] The failure to recognize this distinction would accord the judiciary the power to examine the wisdom of private contracts in order to enforce only those contracts it deemed prudent. The court stated: "[I]t is not 'the function of the courts to strike down private property agreements and to readjust those property rights in accordance with what seems reasonable upon a detached judicial view.' *Oosterhouse, supra* at 289-290, 72 N.W. 2d 6. Rather, absent some specific basis for finding them unlawful, courts cannot disregard private contracts and covenants in order to advance a particular social good."[30] "As we said in *Oosterhouse, supra* at 288, 72 N.W. 2d 6, '[w]e do not substitute our judgment for that of the parties, particularly where, as in the instant case, restrictive covenants are the means adopted by them to secure unto themselves the development of a uniform and desirable residential area.'"[31]

The court further found that there was a strong competing public policy that is well grounded in the common law of Michigan supporting the right of property owners to create and enforce covenants affecting their property.[32] A covenant running with the land is a contract created with the intention of enhancing the value of the property and, as such, is a valuable property right.[33] The general rule of contracts is that competent persons shall have the utmost liberty of contracting and that their agreements voluntarily and fairly made shall be held valid and will be enforced in the courts.[34]

The court found that restrictions for residential purposes, if clearly established by proper instruments, are favored by definite public policy. The court stated: "They expressly prohibit non-residential uses, as well as commercial, industrial or business uses. Clearly, the intention is to limit the use of the property in order to maintain a residential neighborhood of a specific character. This Court has not hesitated in proper cases to restrain by injunction the invasion of these valuable property rights. It is the function of the Courts to protect such rights through the enforcement of covenants." [35]

IV. APPLICATION OF RESTRICTIVE COVENANTS TO THE MINERAL ESTATE

Because they are easements – interests in real property– their first recordation gives restrictive covenants priority over any other easements thereafter recorded or created. The property rights and reciprocal negative easements contained in restrictive covenants apply to and govern the estate existing at the time of their recording.

Therefore, it is not surprising that courts in jurisdictions outside of Michigan have held that when restrictive covenants are recorded on the property prior to the severance of the mineral estate, the mineral estate is burdened by the restrictive covenants.[36] Courts outside of Michigan have also found that restrictions limiting uses to residential purposes prohibit the use of such property for the drilling of oil and gas wells and the property is not subject to the ordinary right of an oil and gas lease to the extent of drilling an oil and gas well thereon.[37]

In *Property Owners of Leisure Land*, the court held that the mineral owner could not be limited by restrictive covenants that were imposed by the surface owners after the minerals were severed.[38] The court stated "since the restrictive covenants were imposed subsequent to the severance of the minerals in and under the subdivision, they do not determine the scope of the implied surface easements that are incidental to the ownership of the minerals."[39]

In a case of first impression in Michigan, the Michigan Court of Appeals recently held in *The Mabel Cleary Trust v The Edward Marlah Muzyl Trust*[40] that restrictive covenants determine the scope of implied surface easements that are incidental to the ownership of minerals that were not severed from the surface of the subdivision when the restrictive covenants were imposed. *Mabel Cleary* is the flip side of *Leisure Land* as, unlike the plaintiff in *Leisure Land*, the plaintiff in *Mabel Cleary* enforced restrictive covenants that were imposed prior to the severance of the minerals.

In *Mabel Cleary*, the defendant developers purchased property now known as Sturgeon River Estates from Otsego Ski Club ("Otsego") in 1996. When selling the property to the defendant developers, Otsego retained an undivided 50 percent of the minerals and conveyed the other 50 percent of the minerals to the defendant developers. The defendant developers developed the property into the Sturgeon River Estates Subdivision and designed and recorded restrictive covenants applicable to all property within Sturgeon River Estates, except for Otsego's undivided 50 percent mineral interest.[41] The restrictive covenants were recorded in 1997. As the defendant developers sold the lots in the subdivision, they retained the mineral rights, thereby severing their 50 percent mineral interest from the surface estate when each lot was conveyed to the purchaser.

The plaintiff purchased three lots in Sturgeon River Estates from the defendant developers. The plaintiff purchased the property in reliance upon the restrictive

covenants that prohibited all commercial activity and restricted the use of the property to residential purposes only. After the last lot in the subdivision was sold, the defendant developers leased their mineral interest to Paxton Resources for the exploration and development of Antrim gas within the subdivision. When development of the minerals through the drilling of Antrim gas wells, laying of pipelines, and construction of access roads within the subdivision was initiated, litigation ensued against the defendant developers and Paxton Resources.

The plaintiff claimed fraudulent misrepresentation, breach of contract, misrepresentation or fraud by real estate broker, conspiracy, negligent misrepresentation, trespass, nuisance, and breach of warranty of title against the defendants and also sought injunctive and declaratory relief. The plaintiff claimed, among other things, that the development of the mineral estate violated the restrictive covenants. Specifically, the plaintiff claimed that the developer's mineral estate is subject to the restrictive covenants, as the restrictive covenants were recorded upon the property prior to the severance of the developer's mineral interest; the drilling of an Antrim gas well within the subdivision was a commercial activity that violated the prohibition against commercial activity in the restrictive covenants; the easement retained by the developers on the east border of the sites did not specifically provide for an Antrim gas well; and even if the easement provided for an Antrim gas well, the gas well in question was not located on the east border of the sites because it was drilled 186 feet west of the east border of the property.

Two main provisions of the restrictive covenants are the focus of the *Mabel Cleary* case. The first provision pertains to the limitation for residential purposes:

> All sites shall be used for single family residential purposes only. All structures are to be styled in keeping with the plans for development. Care must be exercised to maintain the natural beauty of the site. No commercial enterprise shall be conducted thereon. Said premises may be leased or rented in whole or in part from time to time for residential purposes only.[42]

The second provision at issue is an easement for mineral development that was retained by the developers on the east side of the property. That provision reads in pertinent part:

> An easement, sufficient in size, for a well head private gas line, and or oil well shall be reserved by the developer on the east border of the sites including access, ingress and egress sufficient in size to meet developers' needs.[43]

The trial court held that the development of the minerals within the subdivision was not a "commercial activity" and was not precluded by anything in the restrictive covenants.[44] Additionally, the trial court held that the easement retained by the developers on the east side of the property specifically allowed the drilling of an Antrim gas well. The trial court granted summary disposition in favor of defendants. [45]

The plaintiff appealed and the Michigan Court of Appeals affirmed in part and reversed in part. The court held that it is clear that the developer's 50 percent mineral interest is burdened by the restrictive covenants, as the covenants were in place before the developers severed their mineral interest from the surface estates.[46] Therefore, those restrictive covenants determine the scope of the surface use that can be undertaken by developers in the development of their undivided 50 percent mineral interest.

Despite this finding, the court then questionably held that: 1) the development of gas well heads in general is not prohibited by the restrictive covenants because the prohibition against commercial activity within the subdivision would prohibit gas exploration if a *resident* undertook such an operation. Since the developers, through its lessee Paxton, would be the entity charged with operating the commercial enterprise (and not the residents) this provision of the restrictive covenants would not prevent developers from developing their mineral interest; and 2) the covenants clearly provide for mineral development in the form of gas wells.[47]

Although this author disagrees with portions of the *Mabel Cleary* opinion as noted above, the case is still an important decision for Michigan real property and oil and gas law. The *Mabel Cleary* opinion clearly provides that the development of the mineral estate is subject to restrictive covenants that are recorded on the property prior to the severance of the mineral interest (i.e., while the mineral estate is still part of the surface estate) and therefore must be in conformance with those restrictive covenants. The subordination of the mineral rights to the restrictive covenants is crucial in protecting the rights of those who purchase property in reliance upon those covenants.

Endnotes

1. *See* Susan Hlywa Topp, *Severed Minerals: Are Surface Owners Entitled to Damages for Diminution of Their Property Value?* 78 Mich. B.J. 148 (1999).

2. *Jaenicke v Davidson*, 290 Mich 298; 287 NW 472 (1939); *Eadus v Hunter*, 268 Mich 233; 256 N.W. 323 (1934).

3. *VanSlooten v Larsen*, 410 Mich 21; 299 NW2d 704 (1980), app dis *Craig v Bickle*, 455 U.S. 901; 102 Sct 1242; 71 L.Ed.2d 440 (1982); *Southwestern Oil Co v Wolverine Gas and Oil Inc*, 181 Mich App 589 (1989).

4. *Rathbun v State*, 284 Mich 521; 280 NW 35 (1938); *Stevens Mineral Co v State*, 164 Mich App 692; 418 NW2d 130 (1987).

5. *Id*.

6. *VanAlstine v Swanson*, 164 Mich App 396; 417 N.W. 2d 516 (1987).

7. *See* generally *Williams & Meyers. Oil and Gas Law* (2000); *see also* Christopher M. Alspach, *Surface Use by the Mineral Owner: How Much Accommodation is Required Under Current Oil and Gas Law?* 55 Okla. L. Rev. 89 (2001) for a summary of such case law.

8. *F. Glade Wall et al v Shell Oil Company et al*, 209 Cal App 2d 504; 25 Cal Reporter 908 (1962, *hearing denied* January 8, 1963).

9. *Id* at 516.

10. *Id* at 913.

11. *Id* at 514.

12. *Cooper v Kovan*, 349 Mich 520, 84 NW2d 859 (1957).

13. *Austin v Van Horn*, 245 Mich 344, 222 NW 721 (1929).

14. *Webb v Smith*, 204 Mich App 564, 516 NW2d 124 (1994), *appeal after remand on other grounds*, 234 Mich App 203, 568 NW2d 378 (1997).

15. *Central Advertising Company v Michigan State Highway Commission*, 12 Mich App 314, 162 NW2d 834 (1968), Aff'd 388 Mich 1, 172 NW2d 432 (1969).

16. *Unverzagt v Miller*, 306 Mich 260, 10 NW2d 849 (1943).

17. *Kaplan v City of Huntington Woods*, 357 Mich 612, 99 NW2d 514 (1959).

18. *Rofe v Robinson*, 415 Mich 345, 329 NW2d 704 (1982); *Cooper v Koven*, 349 Mich 520, 84 NW2d 859 (1957).

19. *Bassett Bldg. Co. v Jehovah Evangelical Church*, 371 Mich 459, 124 NW2d 236 (1963).

20. *Joseph O'Conner et al and Shanty Creek Lodge Association, Inc. v Resort Custom Builders, Inc, et al*, 459 Mich 335, 591 NW2d 216 (1999).

21. *Janice Terrien, Thomas Hagan and Janet Thomas v Laurel Zwit, et al.*, 467 Mich 56, 648 NW2d 602 (2002).

22. *Id*. at 59.

23. *Id*. at 62-63.

24. *Terrien* at 64, citing *Random House Webster's College Dictionary and Black's Law Dictionary*.

25. *Terrien, supra* at 64.

26. *Id*.

27. *Id*.

28. *Id*. at 65.

29. *Id*. at 69.

30. *Id*. at 69-70, citing *Oosterhouse v Brummel*, 343 Mich 283, 72 NW2d 6 (1955).

31. *Terrien, supra* at 70.

32. *Id*. at 70-71.

33. *Id*. at 71, citing *City of Livonia v Dep't of Social Services*, 423 Mich 466, 378 NW2d 402 (1985).

34. *Terrien, supra* at 71, citing *Twin City Pipe Line Co. v Harding Glass Co*., 283 U.S. 353, 356, 51 S.Ct. 476 (1931).

35. *Terrien, supra* at 72.

36. *Reed v Williamson*, 87 NW2d 18 (Neb. 1957); *Property Owners of Leisure Land, Inc. et al v Woolf & Mcgee, Inc*, 786 SW2d 757 (Tex. Ct. App. 1990).

37. *Reed v Williamson, supra* quoting *Southwest Petroleum Co. v Logan*, 180 Okla. 477, 71 P2d 759, 760 (1937), also citing *Arlt. v King*, 328 Mich. 645, 44 NW2d 195 (1950); *Redfern Lawns Civic Assoc v Currie Pontiac Co.*, 328 Mich 463, 44 NW2d 8 (1950); *West Bloomfield Co. v Haddock*, 326 Mich 601, 40 NW2d 738 (1950).

38. *Leisure Land, supra* at 759 (emphasis added).

39. *Id*.

40. *The Mabel Cleary Trust v The Edward Marlah Muzyl Trust*, 262 Mich.App. 485, – N.W.2d –, 2004 WL 1366029 (Mich.App. Jun 17, 2004) (NO. 244744).

41. The court found that the restrictive covenants do not encumber Otsego's 50% minerals interests because the restrictive covenants were recorded after Otsego's minerals had been severed from the surface estate. *Id.*

42. Sturgeon River Estates Covenants, Conditions and Restrictions, recorded at Liber 0659, Page 738, Ostego County Records, State of Michigan.

43. *Id.*

44. *The Mabel Cleary Living Trust, by Cleland J. Leask, Successor Trustee v Dale J. Smith Broker, Inc, a Michigan corporation, William J. Muzyl, The Joint Revocable Living Trust of Edward and Marlah Muzyl, by William*

Muzyl, Successor Trustee, Paxton Resources, LLC, a Michigan limited liability company, and Thomas and Susan Tomkow, Otsego Circuit Court, Case No: 01-9470-CZ (D) (October 16, 2002).

45. *Id*. The trial court also held that non-party Otsego, which had also leased their 50% mineral interest to Paxton Resources, could develop their half of the minerals irrespective of the restrictive covenants.

46. *Supra* note 40.

47. *Id*. The plaintiff has filed an application for appeal, which is pending, to the Michigan Supreme Court on these issues.