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SALE OF PROPERTY OF THE ESTATE FREE AND CLEAR OF RESTRICTIONS AND COVENANTS IN BANKRUPTCY

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Estate maximization is the watchword of the bankruptcy faithful. Undeniably, one of the principle purposes of bankruptcy law is to maximize assets of the estate for the benefit of unsecured creditors. [*FN:* See generally 1 Bankr. Serv. L. Ed. §§ 1:2, 1:4, 1:5 (1994) (discussing collective nature, principles and goals of bankruptcy proceedings).] Often, this task is achieved at the expense of some other entity. [*FN:* See David Gray Carlson, The Dubious Foundations of Securitization (Unpublished manuscript) (on file with the author).] Section 363 of the Bankruptcy Code (the "Code") [*FN:* 11 U.S.C. § § 101−1330 (1994).] permits a bankruptcy trustee to use, sell, or lease property of the estate both in and outside of the ordinary course of the debtor's business. [*FN:* See id. § 363(b)(1), (c)(1).] One of the powers reserved to the bankruptcy trustee is the power to sell property of the estate "free and clear of any interest in such property of an entity other than the estate" if certain conditions have been met. [*FN:* See id. § 363(f) (setting forth five criteria, only one of which must be met to permit sale).] To be sure, a party with an interest in the property sold under section 363 is entitled to adequate protection. [*FN:* See id. § 363(e) (stating sale may be conditioned as is necessary to provide adequate protection of such interest).] This power of sale vested in the bankruptcy trustee is not without limits. [*FN:* See 11 U.S.C. § 363(f); but see id. § 1206 (providing that sale of farmland or farm equipment by trustee under chapter 12 may be accomplished without satisfaction of conditions set out in § 363(f)).] Section 363(f) sets out five criteria; [*FN:* See id. § 363(f); see also infra text accompanying note 35 (setting forth five criteria).] if any one of the five is satisfied, then the sale is permissible. [*FN:* See 11 U.S.C. § 363(f); see also Citicorp Homeowners Serv. Inc. v. Elliot (*In re* Elliot), 94 B.R. 343, 345 (E.D. Pa. 1988) (holding implied consent to sale sufficient to satisfy the consent requirement of § 363 (f)(2)); Hargrave v. Pemberton (*In re* Tabone Inc.), 175 B.R. 855, 858 (Bankr. D.N.J. 1994) (same).] Additionally, section 363(g) permits a sale by the bankruptcy trustee free and clear of any vested or contingent right in the nature of dower or curtesy. [*FN:* 11 U.S.C. § 363(g).] Furthermore, section 363(h) permits a sale by the bankruptcy trustee of both the estate's and a co−owner's interest in property of the estate. [*FN:* *Id.* § 363(h).]

Within the context of section 363, may a bankruptcy trustee sell property of the estate free and clear of deed restrictions or reciprocal land covenants? Courts that have addressed the issue have answered no. [*FN:* See Gouveia v. Tazbir, 37 F.3d 295, 297 (7th Cir. 1994) (holding trustee could not sell land free of reciprocal land covenant); *In re* 523 E. Fifth St. Hous. Preservation Dev. Fund Corp., 79 B.R. 568, 571 (Bankr. S.D.N.Y. 1987) (holding covenant could not be extinguished).] This article disagrees with the decisions of the courts and asserts that section 363(f) permits the sale of property of the estate free and clear of restrictions and covenants.

This article will explore the premise that a bankruptcy trustee may not sell property free and clear of restrictions and covenants. [*FN:* The term "restrictions" as used in this article is intended to encompass both real covenants running with the land and equitable servitudes.] First, it will be argued that the Bankruptcy Code compels no such conclusion. Second, it will be asserted that the Bankruptcy Code's policy favoring maximization of value for the unsecured creditors is furthered by permitting sales free and clear of restrictions and covenants. Such sales are no less "offensive" than sales free and clear of dower and curtesy rights or the interests of co−owners, sales expressly recognized under the Bankruptcy Code. [*FN:* See 11 U.S.C. § 363(g), (h).]

Part I commences with the statutory foundations of sales free and clear of interests in a bankruptcy case. Part II discusses those cases that have held that a bankruptcy trustee may not sell property of the estate free and clear of restrictions and covenants. Part III argues that section 363(f) itself permits sales free and clear of restrictions, and that Bankruptcy Code policies are furthered by the model of section 363(f) constructed in this article.

I. Sales Free and Clear of Any Interests

A. Restrictions and Covenants: A Story [*FN:* See Mari J. Matsuda, Voices of America: Accent, Antidiscrimination Law, and a Jurisprudence for the Last Reconstruction, 100 Yale L.J. 1329, 1331−32 (1991) (stating use of stories is within a legitimate scholarly tradition); see also Richard Delgado, Storytelling For Oppositionists and Others: A Plea For Narrative, 87 Mich. L. Rev. 2411, 2440 (1989) (stating stories are valuable "tools" necessary to "test" reality).]

Let us consider an example where the sale of property free and clear of restrictions and covenants in bankruptcy is beneficial to the debtor, its creditors, and society, without penalizing the beneficiary of the restriction or covenant (as the case may be). Assume an inexperienced landowner, whom we shall call "Developer", owns two thousand acres of land close to a large lake. Developer decides that the two thousand acres are the perfect location for an industrial park devoted to manufacturing. Developer is aware that many businesses have encountered difficulties from residential neighbors because of the impact of noise, dust, traffic and other matters that are often associated with the operation of a manufacturing facility. [*FN:* See, *e.g.* , Copart Indus. Inc. v. Consolidated Edison Co. of N.Y. Inc., 41 N.Y.2d 564, 567 (1977) (discussing elements of public nuisance in New York); Boomer v. Atlantic Cement Co., 26 N.Y.2d 219, 225 (1970) (granting injunction that would be vacated upon payment by defendant of permanent damages to plaintiffs for "servitude" imposed on lands).] Developer believes that if he restricts the use of the two thousand acres to industrial use only, he can successfully sell all the industrial lots to manufacturing concerns. One of the first steps Developer undertakes is to properly impose restrictions that prohibit the use of the land for residential purposes. Developer takes the proper formal steps to impose these restrictions, [***FN:*** See Net Realty Holding Trust v. Franconia Properties Inc. 544 F. Supp. 759, 762 (E.D. Va. 1982) (discussing "running with the land" criteria). See generally Cunningham, *et al.* The Law of Property §§ 8.13−8.33, (2d. ed. 1993). In order for a real covenant to run with the land, most courts require that the parties to the covenant (i) intend that the covenant run with the land, (ii) that the covenant touch and concern the land, and (iii) that there be privity of estate between the promisor and the promisee. ***Id.*** at 466−504. Equitable servitudes likewise require the intent and touch and concern elements to be enforceable against successors, but substitute notice for the requirement of privity of estate. ***Id.*** In addition, as a general rule both real covenants and equitable servitudes must comply with the statute of frauds. *Id.*] and records the restrictions in the appropriate real property records to put the world on notice. [*FN:* See generally Cunningham *et al.* supra note 17, § 11.9, at 823−33 (recording restrictions assures that successors who would otherwise qualify as bona fide purchasers are bound by restrictions).]

Next, Developer begins to put the infrastructure in place for the industrial park. In doing so, Developer incurs substantial expense in connection with the legal work, grading and installing of roads and utilities. Developer anticipates paying these expenses from the proceeds generated by the sale of the industrial lots.

Shortly after completion of the project, Developer is able to sell quickly four acres located on the most northwestern portion of the park to Re−Movall, a local trash collection company. Re−Movall had been receiving complaints from its neighbors regarding the storage of dumpsters and trucks. According to the neighbors, the storage had caused excessive levels of odor, flies and noise. Re−Movall wanted to relocate to the industrial park so that it would no longer have to deal with these complaints. Developer, being anxious to begin attracting businesses, with the expectation that others would follow, quickly sold the four acres to the trash collection company at a very favorable price.

Despite undertaking a massive marketing campaign, the initial sale of the four acres was the only sale Developer was able to close. In connection with this campaign, Developer incurred significant additional debt by spending large sums for advertising and employees to market the property. As with the prior expenses, Developer expected to be able to repay these additional debts from the sale of the developed lots.

Despite the development of the land and the massive marketing campaign, no other businesses have been attracted to the area. Developer now realizes that the location of the industrial park was a poor selection and that he has made a huge mistake. According to every business that Developer approached, the location is too far from a source of skilled labor, raw materials and a market for the finished product or services. Furthermore, each prospect Developer

contacted was concerned about the proximity of the industrial park to the large lake. Those prospective tenants feared that operations in that location may result in having to defend in the future against claimed environmental liabilities. The tenant's primary concern is runoff of contaminants from the industrial park into the lake. In short, Developer's industrial park is a complete failure. Developer is unable to pay his employees and creditors and is forced to file bankruptcy amidst this huge mountain of debt. Developer's only asset is the two thousand acre industrial park, which has a value of practically zero, inasmuch as it is unmarketable because of the restrictions.

Initially, Developer filed for relief under chapter 11 of the Bankruptcy Code [*FN:* See 11 U.S.C. § 1101 *et seq.* (1994).] and operated the business as the debtor−in−possession, marketing and attempting to sell the property. [*FN:* See id. § 1108 (authorizing continued operation of debtor's business).] Unable to sell the property with the restrictions or otherwise reorganize the debtor, the bankruptcy court converted the chapter 11 case to a case under chapter 7 of the Bankruptcy Code. [*FN:* See id. § 1112 (permitting court for cause to convert cases from chapter 11 to chapter 7).] The United States Trustee, an officer of the Department of Justice, appointed a chapter 7 trustee [*FN:* See id. § 701. Technically, the United States Trustee appoints an interim trustee who becomes the permanent trustee unless creditors elect another trustee. See id. § 702 (stating creditors may vote for candidate for trustee subject to certain conditions which if not met result in interim trustee serving as permanent trustee).] to run the affairs of the debtor, collect and liquidate assets, identify and challenge claims, and distribute property of the estate in accordance with bankruptcy priorities. [*FN:* See 11 U.S.C. § 704.]

Although Developer was unable to find a purchaser of the property, the chapter 7 trustee has located a prospective purchaser of the property that is willing to pay $10,000/acre, or approximately $20 million for the property. The prospective purchase price is more than adequate to pay all the employees and creditors in full, with a surplus remaining. The sole problem is that the prospective purchaser, whom we will call Re−Developer, is interested in the property only if she can use it for residential purposes. It seems that many of the same attributes of the property that make it undesirable for manufacturing use, make the property highly desirable for residential use. These attributes include the distance from the noise, crime and congestion that residents associate with higher density areas, and the perceived beauty and recreational benefits associated with the nearby lake.

The chapter 7 trustee has filed a motion requesting the bankruptcy court to approve a sale of the land free and clear of all interests in the property, [*FN:* In some districts, the bankruptcy bar refers to the motion as a "sale free and clear of all liens, claims and encumbrances." See *e.g.* *,In re* Oyster Bay Cove, Ltd., 161 B.R. 338, 343 (Bankr. E.D.N.Y. 1993), aff'd , 196 B.R. 251 (E.D.N.Y. 1996). The actual language in § 363(f) is broader, permitting the sale free and clear of any interest in the property . 11 U.S.C. § 363(f) (emphasis added).] including the restrictions prohibiting the use of the property for residential purposes. [*FN:* The request to sell the property constitutes a contested matter under Bankruptcy Rule 9014. Such an action is commenced by the filing of a motion by the trustee. Fed. R. Bankr. P. 9014.] The trustee's motion contemplates that the holder of the benefit of the restriction, Re−Movall, would have the value of its interest attach to the proceeds of the sale [*FN:* See 11. U.S.C. § 363. The sale of property free and clear of an interest is subject to the adequate protection requirement. *Id.* § 363(e). According to the legislative history of § 363, "most often, adequate protection in connection with a sale free and clear of other interests will be to have those interests attach to the proceeds of the sale." H.R. Rep. No. 95−595, at 5 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6302.] and would be paid from such proceeds before distribution to any employees, creditors or others holding unsecured claims. Re−Movall has objected to the sale of the property, and has asserted that it continues to enjoy the benefits of not having the land around its operations used for residential purposes.

Prior to the chapter 7 trustee filing her motion to sell the property pursuant to section 363, the trustee has attempted to negotiate with Re−Movall to either purchase Re−Movall's land, or obtain a release of the restrictions. Re−Movall is more than willing to do either, and could easily relocate to another location. The benefits of the restrictions to Re−Movall are minimal, who by now realizes that it has located too far from where it provided its services to operate economically. However, Re−Movall understands that without its property or its release of the restrictions, the land has little value. Re−Movall, therefore, insists on no less than $10 million for its consent. The $10 million largely reflects what Re−Movall views as the value of its "hold out" position, and its ability to prevent the trustee's sale. This money would, of course, come out the proceeds of the sale to the great harm of the debtor's employees and creditors.

If the bankruptcy court were to refuse to approve the trustee's motion for the sale of the property free and clear of the restrictions, it would not only deprive the employees and creditors of payment of the monies due them, but would also prevent the area from being developed for its most appropriate use. The refusal to approve the motion would deprive

the community and its residents from both the opportunity to reside in that location and the tax base associated with the development. The only party to benefit from such a refusal would be Re−Movall, who, in its monopolistic position, could hold out and perhaps ultimately acquire the property for much less than its best−use value. At that point, Re−Movall could release the benefit of the restrictions, and then sell the entire property itself for $20 million. Because of this monopolistic position, Re−Movall can virtually acquire two thousand acres for the price of four acres. This would be the result of a very poor decision by Developer, making the land practically unmarketable and causing harm to the creditors and community at large. Developer's poor decision would be exacerbated by a bankruptcy court deciding the trustee's requested relief is not permissible under the court's interpretation of section 363. Nonetheless, the few courts addressing the issue thus far have read section 363 in just that fashion. [*FN:* See Gouveia v. Tazbir, 37 F.3d 295, 299 (7th Cir. 1994) (holding trustee may not sell property free of restriction under § 363); *In re* 523 E. Fifth St. Hous. Preservation Dev. Fund Corp., 79 B.R. 568, 576 (Bankr. S.D.N.Y. 1987) (prohibiting sale of property free of covenant pursuant to § 363(f)).]

As currently written, the Code provides ample opportunity for courts to authorize the sale of property free and clear of covenants and servitudes, [*FN:* See 11 U.S.C. § 363(f).] notwithstanding the courts' refusal to do so thus far. [*FN:* See Gouveia , 37 F.3d at 300 (prohibiting sale free of covenant under § 363); 523 E. Fifth Street , 79 B.R. at 576 (same).] As explained in this article, courts should be willing to authorize such a sale pursuant to either section 363(f)(1), (f)(3), or (f)(5). The authorization of such a sale is supported by the Bankruptcy Code itself and by strong policy considerations.

B. Sale of Estate Property Free and Clear

In order to maximize the return to the unsecured creditors of the estate and to further the rehabilitative efforts of the debtor, section 363(b)(1) provides that a trustee, [*FN:* See 11 U.S.C. § 363(b)(1). In a case under chapter 11, where no trustee has been appointed, a debtor−in−possession may operate the business of the debtor. See id. § 1107 (providing that subject to limitations, debtor−in−possession will have all rights, power and duties of trustee under chapter 11) .] "after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." [*FN:* See id. § 363(b)(1); see, *e.g.* ,*In re* Taylor, 198 B.R. 142, 158 (Bankr. D.S.C. 1996) (stating sales under § 363(b) are limited to sales of estate property); McLean Indus. Inc. v. Medical Lab. Automation Inc. (*In re* McLean Indus. Inc.), 96 B.R. 440, 443−446 (Bankr. S.D.N.Y. 1989) (analyzing § 363(b)'s applicability, but not found to be violated in case); cf. WBQ Partnership v. Commonwealth of Va. Dep't of Med. Assistance Servs. (*In re* WBQ Partnership), 189 B.R. 97, 102 (Bankr. E.D. Va. 1995) (explaining court's method for preventing debtors from using § 363(b) as vehicle for circumventing creditor protections).] Section 363(c)(1) provides:

[i]f the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing. [*FN:* 11 U.S.C. § 363(c)(1).]

Where others have an interest in property of the estate, the threshold inquiry still must center on section 363(b) or (c)(1) before any of the property may be sold outside the ordinary course of business. [*FN:* See, *e.g.* , Sony Music Entertainment Group Inc. v. Clark Entertainment Group Inc. (*In re* Clark Entertainment Group Inc.), 183 B.R. 73, 81 (Bankr. D.N.J. 1995) (finding court must enforce policies of Code and allow debtor−in−possession to sell tapes if either § 363(b) or (c) is satisfied); *In re* Signal Hill−Liberia Ave. Ltd. Partnership, 189 B.R. 648, 651 (Bankr. E.D. Va. 1995) (noting § 363(f) conditionally authorizes trustee to sell property under § 363(b) or (c) free and clear of any interest in the property); Shaia v. Conoco Inc. (*In re* Williams Contract Furniture Inc.), 148 B.R. 805, 808 n.5 (Bankr. E.D. Va. 1992) (stating in order for § 363 to be used as authority for showing act was authorized under § 363(b)(1) requires notice and hearing if transaction is not in ordinary course of business and § 363(c)(1) nonetheless requires court authorization under chapter 7 for transactions in ordinary course of business).] Thus, section 363(f), (g), and (h) may be understood as a further limitation on a trustee's power to sell property either in or outside the ordinary course of business. [*FN:* See 1 David G. Epstein *et al.* , Bankruptcy § 4−7, at 399 (1992).] More specifically, section 363(f) provides:

[t]he trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if)

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. [*FN:* 11 U.S.C. § 363(f).]

Since conditions on sale under section 363 are stated in the disjunctive, a sale under section 363(f) is proper if any one of the five conditions are met. [*FN:* See id. ; supra notes 8−9 and accompanying text.] Additionally, the interest holder's right to adequate protection limits sales free and clear of those interests. In particular, section 363(e) provides:

[n]otwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362). [*FN:* 11 U.S.C. § 363(e).]

In this context, a closer look at section 363(f) is warranted. The legislative history states:

[s]ubsection (f) permits sale of property free and clear of any interest in the property of an entity other than the estate. The trustee may sell free and clear if applicable nonbankruptcy law permits it, if the other entity consents, if the interest is a lien and the sale price of the property is greater than the amount secured by the lien, if the interest is in bona fide dispute, or if the other entity could be compelled to accept a money satisfaction of the interest in a legal or equitable proceeding. Sale under this subsection is subject to the adequate protection requirement. Most often, adequate protection in connection with a sale free and clear of other interests will be to have those interests attach to the proceeds of the sale.

At a sale free and clear of other interests, any holder of any interest in the property being sold will be permitted to bid. If that holder is the high bidder, he will be permitted to offset the value of his interest against the purchase price of the property. Thus, in the most common situation, a holder of a lien on property being sold may bid at the sale, and if successful, may offset the amount owed to him that is secured by the lien on the property (but may not offset other amounts owed to him) against the purchase price, and be liable to the trustee for the balance of the sale price, if any. [*FN:* H.R. Rep. No. 95−595, at 5 (1977), reprinted in 1978 U.S.C.A.A.N. 5963, 6301−02.]

In sum, although section 363(f) is an enigma, [*FN:* See Epstein *et al.* , supra note 34, § 4−7, at 403.] it seems to have been designed with the disencumberance of liens in mind. [*FN:* See id. § 4−7, at 404.] Note, however, that the statute itself is much broader, a trustee may sell free and clear of "any interest in such property." [*FN:* 11 U.S.C. § 363(f).]

II. AUTHORITIES ADDRESSING SECTION 363 SALES FREE

AND CLEAR OF RESTRICTIONS AND COVENANTS

As previously discussed, section 363(f) permits a trustee to sell property of the estate free and clear of any interest in the property if any one of five conditions is met. [*FN:* See id. § 363(f)(1)−(f)(5); supra notes 8−9, 35−36 and accompanying text.] In the context of a proposed sale of property free and clear of restrictions, the debate has primarily centered on section 363(f)(5). Section 363(f)(5) permits a sale free of another's interest if the third party could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. [*FN:* See 11 U.S.C. § 363(f)(5).] Although section 363(f)(5) is generally used to sell property of the debtor's estate free and clear of monetary liens, debtors in possession have also attempted to use this subsection to sell property free and clear of other interests, including restrictions and covenants. [*FN:* See WBQ Partnership v. Commonwealth of Va. Dep't of Med. Assistance Servs. (*In re* WBQ Partnership), 189 B.R. 97, 99 (Bankr. E.D. Va. 1995) (considering propriety under § 363(f)(5) of debtor's postpetition agreement contemplating sale of estate property free and clear of defendant's right of recapture);*In re* Crabtree, 112 B.R. 420, 422 (Bankr. W.D. Okla. 1989) (addressing trustee's request pursuant to § 363(f)(5), to sell debtor's residence free of both homestead exemption and creditor bank's interest in order to produce greater

monetary return for bankruptcy estate); Gerdes v. Gerdes (*In re* Gerdes), 33 B.R. 860, 870−71 (Bankr. S.D. Ohio 1983) (considering husband's request pursuant to § 363(f)(5) to sell marital asset free of wife's tenancy in common interest to facilitate divorce settlement).]

One of the earlier cases addressing section 363 sales free and clear of restrictions is *In re 523 East Fifth Street Housing Preservation Development Fund Corp.* [*FN:* 79 B.R. 568 (Bankr. S.D.N.Y. 1987).] In *523 East Fifth Street*, the debtor sought authority to sell certain real property located in New York City, free and clear of all liens, encumbrances and covenants. [*FN:* See id. at 570.] The property at issue was subject to a restrictive covenant, running in favor of the City of New York, that required the property to be used only for low−income housing. [*FN:* See id. at 569 (reviewing extent of restrictive covenant in deed).] The chapter 11 debtor moved for authorization to sell the real property free and clear of the covenant requiring the property to be used solely for low−income housing. [*FN:* See id. at 570.] The debtor argued that the bankruptcy court has the power to order the sale of the property under section 363(f)(1) and (5), free and clear of the restrictive covenant. [*FN:* See id. at 570−71.]

The court, however, disagreed [*FN:* See 523 E. Fifth St. , 79 B.R. at 571.] and held that the covenant could not be voided under the New York statutes governing enforceability of restrictive covenants. [*FN:* See id. at 571−72.] This conclusion was supported by the fact that the covenant, which was contained in the deed conveying the property from the City to the debtor, was created for public purposes by a governmental unit. [*FN:* See id. The court further noted that under New York law, a party seeking to attack the enforceability of a covenant has the burden to prove: (1) lack a of benefit derived from the enforcement of the covenant; and (2) a legally cognizable reason for extinguishment of covenant. *Id.* at 572. The court concluded that the debtor failed to bear this burden. *Id.* at 573.] Moreover, the court observed that the covenant could not be extinguished under New York common law because the debtor and the City intended the covenant to run with the land, and the covenant did "touch and concern" the land. [*FN:* See 523 E. Fifth St. , 79 B.R. at 574−75.] Finally, the court determined, on equitable grounds, that the debtor, which had paid nominal consideration to acquire the property from the City, was not entitled to relief. [*FN:* See id. at 576.] Because the City had not abandoned its goal of alleviating the low−income housing shortage problem via the debtor's property, the balance of equities favored the City and not the debtor. [*FN:* See id.] Ultimately, the court concluded that the City could not be compelled to accept a money satisfaction of its interest. [*FN:* See id.]

At this point, it is beneficial to unpack carefully the debtor's arguments. First, the debtor asserted that the covenant was extinguished under provisions of the deed itself or under New York law. [*FN:* See id. at 570−71.] Second, the debtor argued that section 363(f) of the Bankruptcy Code authorized the sale of the property free and clear of the covenant. [*FN:* See 523 E. Fifth St. , 79 B.R. at 570−71.] The City's response to both arguments was equally straightforward) "it ain't so." [*FN:* See id. at 570−71, 574.]

First, the court observed that the crux of the debtor's argument was that the debtor could sell free and clear under section 363(f). [*FN:* See id. at 570. "In asserting that the property can be sold free and clear of the covenant, the Debtor principally relies on § 363(f) of the Code." *Id.*] Specifically, the debtor asserted that the City could be compelled in a legal or equitable proceeding to accept a money satisfaction of its interest. [*FN:* See id. at 571; see also N.Y. Real Prop. Acts. Law § 1951 (McKinney 1979) (allowing action to extinguish non−substantial restrictive covenants whether or not land in question is held for public use).] Based on New York law, the court concluded that the City could not be compelled to accept money damages. [*FN:* See 523 E. Fifth St. , 79 B.R. at 571−74.]

Second, the court rejected the debtor's attempt to extinguish the covenant under New York common law. [*FN:* See id. at 574−75.] At common law, covenants were either personal, that is, enforceable only by the original covenantee against the original covenantor, or real covenants running with the land. [*FN:* See id. at 574 (citing Richard R. Powell & Patrick J. Rohan , 5 Powell on Real Property & 670 (1979)).] The covenantee's benefits and covenantor's burdens would devolve upon their respective successive assignees if: (1) there is privity of estate; (2) the original covenanting parties intended the covenant to run; and (3) the covenant touched and concerned the land. [*FN:* See id. ; see also Neponsit Property Owners' Ass'n v. Emigrant Indus. Sav. Bank, 278 N.Y. 248, 254−55 (N.Y. 1938). The court reasoned: [t]he age−old essentials of a real covenant, aside from the form of the covenant, may be summarily formulated as follows: (1) It must appear that grantor and grantee intended that the covenant should run with the land; (2) it must appear that the covenant is one "touching" or "concerning" the land with which it runs; (3) it must appear that there is "privity of estate" between the promisee or party claiming the benefit of the covenant and the right to enforce it, and the promisor or party who rest under the burden of the covenant. Id . (citation omitted); see also Orange & Rockland Utils. Inc. v. Philwold Estates Inc., 52 N.Y.2d 253, 262 (1981) (noting three factors determining whether covenant restricting real property was personal or ran with land) (citing Neponsit, 278 N.Y. at 255). See generally Richard R. Powell & Patrick J. Rohan, 5 Powell on Real Property & 673 (1996) (describing covenants).] The court noted that all three conditions were met and, therefore, the covenant ran with the land. [*FN:* See 523 E. Fifth St. , 79 B.R. at 574 (citing Neponsit , 278 N.Y. at 261). In order for the burden of low income housing restriction to run, the

parties must intend the covenantor's successor be obliged to perform the covenant. Powell & Rohan supra note 65, & 673, at 60−55. The requisite intent is adduced from the character of the entire instrument, however the presence of certain language such as "these covenants shall run with the land," or "the grantee promises for himself, his heirs and assigns," may greatly influence the court's determination. 2 Thomas E. Atkinson et al., American Law of Property § 9.10 at 366 (1952); Powell & Rohan, supra note 65, & 673[2], at 60−62.]

Although the court rejected the debtor's argument in this instance, the court nevertheless left open the possibility that section 363(f)(5) would have permitted the sale of the property free and clear of the negative covenant if it could be shown that applicable law permitted money damages for breach of the negative covenant. [*FN:* See 523 E. Fifth St. , 79 B.R. at 576.] Thus, *523 East Fifth* did not close the door completely on the efforts of a bankruptcy trustee to sell property free and clear of restrictions; the court merely threw the substantive controversy back to applicable nonbankruptcy law. If applicable nonbankruptcy law forced a holder of the benefit of the restriction to accept money damages, then the requirements of section 363(f) are met and the trustee may sell the property free and clear of the restriction. [*FN:* See id. Cf. WBQ Partnership v. Commonwealth of Va. Dep't of Med. Assisatance Servs. (*In re* WBQ Partnership) 189 B.R. 97, 106 (Bankr. E.D. Va. 1995) (noting that if holder of interest cannot be compelled to take money damages in lieu of equitable relief, then sale under § 365(f)(5) cannot go forward).]

One of the more recent decisions and the only Court of Appeals opinion, that directly addresses the issue of selling property free of restrictions under section 363 is *Gouveia v. Tazbir.* [*FN:* 37 F.3d 295 (7th Cir. 1994).] In *Gouveia*, the landowner decided to build a commercial music store on property located in a residential subdivision. [*FN:* See id. at 297.] The property was burdened by a restrictive, reciprocal land covenant prohibiting use of the land for any purpose other than residential building. [*FN:* See id.] The landowner, nonetheless, sought and obtained permission from the city zoning commission for the construction and operation of the music store. [*FN:* See id.] Some neighbors then filed suit in state court seeking to enforce the covenant and enjoin the construction of the store. [*FN:* See id. (noting that covenant specified that neighborhood was restricted to only "single−story, residential property").]

The landowner prevailed before the state trial court, which found that the covenant was unenforceable under Indiana law. [*FN:* See Gouveia , 37 F.3d at 297.] The neighbors immediately appealed the trial court's decision, while the landowner immediately began construction. [*FN:* See id .] Shortly after completion of the building, the state court of appeals reversed the trial court, holding that the covenant was enforceable. [*FN:* See id .] The state court of appeals remanded the case with instructions that the landowner be permanently enjoined from building the music store. [*FN:* See id.]

Having been enjoined from operating the music store business at a most inopportune time, that is, after funds were expended for its construction, the landowner was unable to meet her financial obligations and was forced to seek relief under chapter 11 of the Bankruptcy Code. [*FN:* See id.] The landowner, as debtor−in−possession, sought to sell the property free of the restriction. [*FN:* See Gouveia , 37 F.3d at 297; Cunningham v. Hiles, 395 N.E.2d 851 (Ind. Ct. App. 1979), modified , 402 N.E.2d 17 (Ind. Ct. App. 1980).] The neighbors objected [*FN:* See Gouveia , 37 F.3d at 297.] and the bankruptcy court rejected the debtor's motion. The court held that section 363 did not permit such a sale, and that the restriction did not constitute an executory contract that could be rejected under section 365 of the Code. [*FN:* See id.; 11 U.S.C. § 365(a) (1994) (permitting rejection of unexpired lease).] The bankruptcy court decision was affirmed by the Northern District of Indiana, and appeal was taken to the Court of Appeals for the 7th Circuit. [*FN:* See Gouveia, 37 F.3d at 297.] The debtor's case was subsequently converted to a chapter 7 case wherein, the chapter 7 trustee, Gouveia, was substituted as the party plaintiff. [*FN:* See id.]

In addition to arguing that the covenant was an unenforceable executory contract under section 365 of the Bankruptcy Code, the trustee also argued that the property could be sold free of the neighbors' interest under section 363 because the interest was convertible to monetary damages. [*FN:* See id. at 298.] As such, a sale free of the interest was permissible under section 363(f)(5). [*FN:* See id.] The trustee further argued that a sale free of the interest was also authorized by section 105 of the Code. [*FN:* See id. ; 11 U.S.C. § 105(a) (granting courts power to "issue any order, process or judgment that is necessary . . . to carry out the provisions of" the Code).]

The covenant at issue provided that parties seeking to enforce the covenant had the option of seeking either an injunction or damages. As the neighbors had elected to restrain the violation, the 7th Circuit disagreed with the trustee's position that the property could be sold free of the interest under section 363(f)(5) because the neighbors could not be *forced* to accept a money satisfaction. [*FN:* See Gouveia , 37 F.3d at 299 (stating that language of covenant granted option to pursue

monetary damages, but that landowner cannot be forced to forego equitable relief in favor of cash reward and as such § 363(f)(5) does not apply).] The court concluded that section 363(f)(5) was inapplicable and that the property could not be sold free of the interest. [*FN:* See id.] This holding appears to foreclose the possibility of using section 363(f)(5) to sell property free of restrictions when such restrictions can be construed as equitable servitudes. [*FN:* Equitable servitudes are enforceable in equity, through the equitable remedy of an injunction. See Cunningham *et al.* , supra note 17, at § 8.31 (discussing remedies for breach of equitable restrictions).] The court's opinion contained no discussion of the legal principle that equity would not intervene when an adequate remedy is available at law. [*FN:* See generally , 1 Pomeroy , A Treatise on Equity Jurisprudence (Spencer W. Symons ed., 1949).] Perhaps the court presumed that since land is generally viewed as unique, damages would never be an adequate remedy in lieu of an injunction in this setting. More importantly, the court overlooked the fact that a different plaintiff could very possibly have compelled the neighbors to accept money damages. [*FN:* See infra notes 161−168 and accompanying text (discussing condemnation proceedings).] Any entity with eminent domain authority could easily condemn the neighbors' interest in the debtor's property and force the neighbors to accept a monetary award as just compensation. [*FN:* See infra notes 161−168 and accompanying text (discussing condemnation proceedings).]

One of the more interesting decisions regarding the avoidance of a restrictive use covenant in bankruptcy is *In re Arden & Howe Associates, Ltd.* [*FN:* 152 B.R. 971 (Bankr. E.D. Cal. 1993).] This 1993 California bankruptcy court decision refused to permit the beneficiary of a land use restriction to enforce the restriction by an injunction against the debtor or the debtor's successor. [*FN:* See id. at 978.] Under California law this restriction was found to be a valid restrictive use covenant that would run with the land. [*FN:* See id. at 975 (providing that three requirements must be met: " the contiguous real property must be particularly described in the lease; the lease must provide that successors are bound for the benefit of the demised real property; and the lease must be recorded."); see also Cal. Civ. Code § 1470 (West 1982) (containing same three requirements).] Pursuant to the law of California, the remedies for breach of the covenant are injunction or damages, normally at the election of the covenantee. [*FN:* See Arden & Howe , 152 B.R. at 975; see also Harry D. Miller & Marvin B. Starr , California Real Estate & 18.44 (2d ed. 1989).] Nonetheless, the court held that in this instance where the debtor had filed bankruptcy, the covenant was unenforceable by injunction because of its method of creation. [*FN:* See Arden & Howe , 152 B.R. at 975−76 (stating that § 365(h) preempts California state law remedies allowed in event of breach of lease); see Public Serv. Co. of New Hampshire v. New Hampshire (*In re* Public Serv. Co. of New Hampshire), 108 B.R. 854, 870 (Bankr. D.N.H. 1989) (permitting Bankruptcy Code to preempt state regulatory provisions);*In re* Stable Mews Assocs., 41 B.R. 594, 598 (Bankr. S.D.N.Y. 1984) (recognizing that in some circumstances even laws that are valid exercise of state police power must yield to bankruptcy laws).] In *Arden & Howe*, the land use restriction was created and contained in a lease, which had been rejected by the debtor under section 365 of the Bankruptcy Code. [*FN:* See Arden & Howe , 152 B.R. at 973.]

Arden & Howe Associates, the debtor/landlord, had developed a shopping center in Sacramento, California. [*FN:* See id. at 972.] The lease between the debtor and its anchor tenant contained a restrictive use covenant that prohibited, among other things, the use of any portion of the shopping center for a night club. [*FN:* See id.] When the debtor was unable to lease adequately the remainder of the shopping center, the debtor filed a chapter 11 petition and eventually a chapter 11 trustee was appointed. [*FN:* See id. See also 11 U.S.C. § 1104 (1994) (providing guidelines when court may appoint trustee in chapter 11 proceeding).] The trustee negotiated a lease with a night club. [*FN:* See Arden & Howe , 152 B.R. at 972.] The anchor tenant objected and asked the bankruptcy court to enjoin the execution of the lease as a violation of the restrictive use covenant. [*FN:* See id. at 972−73.] The trustee rejected the anchor tenant's lease, the injunction motion was dismissed, and the night club opened. [*FN:* See id. at 973.] The trustee§s sole purpose in rejecting the unexpired lease with the anchor tenant was to shed the restrictive use covenant. [*FN:* See id.]

The anchor tenant, electing to remain in possession of the premises, brought an action for an injunction enforcing the covenant notwithstanding the lease rejection. [*FN:* See id. (noting that right of tenant to remain in possession after lease has been rejected in bankruptcy is granted under § 365(h)).] The main thrust of the anchor tenant's argument was that the plan of reorganization, which provided that the rejected lease would not be enforceable against the debtor's successor except as set forth in section 365(h), impermissibly took part of the anchor tenant's leasehold. [*FN:* See Arden & Howe , 152 B.R. at 973.]

The *Arden & Howe* court confirmed the plan over the tenant's objection, and held that the covenant was not enforceable against either the debtor or its successor. [*FN:* See id. at 977.] The court recognized that the Code does not permit a taking of the lessee's leasehold estate, but that the Code authorizes the landlord to reject executory lease covenants. [*FN:* See id. at 974; 11 U.S.C. § 365 (1994).] In construing the restrictive use covenant as an executory lease covenant, and permitting rejection under section 365, the court construed this use restriction as more akin to an

executory contract. This conclusion was reached notwithstanding the language of the opinion that states that California law validly established the restrictive use covenant as a property right binding on successors. [*FN:* See Arden & Howe , 152 B.R. at 974−75.] The court specifically held that "such covenants fall when the lease is rejected under section 365, regardless of whether they run with the land." [*FN:* See id. at 976.]

The court rejected the tenant's position that part of the leasehold had been taken; the key factor in the court's view was that the tenants were in possession of the premises. [*FN:* See id. at 975.] Only that portion of the shopping center to which the tenant had possession constituted the leasehold. [*FN:* See id. at 974.] The court stated that "[b]reaches of restrictive use covenants do not ordinarily work a dispossession," and concluded that no part of the tenant's leasehold interest had been taken. [*FN:* See id. at 975.]

This may be a valid interpretation of what comprises the leasehold estate, but this approach left the court to grapple with the question of what did the restrictive use covenant burdening the contiguous portion of the shopping center grant to the tenant? Obviously, the tenant must have some interest in the contiguous non−leased space even if the interest was not part of the leasehold. It appears that the debtor owned property in which another entity had an interest. Specifically, the property located at the contiguous portion of the shopping mall not leased to the anchor tenant, which the debtor seeks to lease free and clear of the restrictive use covenant. Rather than treating this as a lease of property under section 363 in which another entity had an interest, the court treated the restrictive use covenant as having been rejected. Presumably this was accomplished by severing the leasehold and covenant portions of the lease agreement, and then allowing rejection of the covenant portion as an executory contract. The *Arden & Howe* court also found that because of the preemption of section 365 over state law, the sole remedy available to the tenant was the offset against rents provided for in section 365(h)(2). [*FN:* See Arden & Howe , 152 B.R. at 976.]

The end result of the court's decision in *Arden & Howe* appears to further strong currents of bankruptcy policy by allowing the debtor to maximize the value of its assets. [*FN:* See supra notes 2−11 and accompanying text (discussing maximization of assets).] However, it is difficult to justify achieving this end by rejecting unexpired leases under section 365 and eliminating covenants running with the land, but not allowing the sale of property free and clear under section 363. For all practical purposes, in both situations, an identical interest is involved. [*FN:* See Arden & Howe , 152 B.R. at 974−75 (explaining that lease is conveyance of real property and that restrictive use covenants run with land conveyed under lease).] Basically, only the method by which the interest was created differs. [*FN:* See id. (noting that lease of real property creates property right for lessee).] The next anchor tenant to face this situation should insist on two documents: one to create the leasehold estate, and a second to create a use restriction on the contiguous portions of the shopping center for a comparable period of time.

One of the most detailed and exhaustive treatments of the disencumberance of restrictions may be found in an article by Professor David Gray Carlson at Cardozo Law School. [*FN:* David Gray Carlson, Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created By Running Covenants, Products Liability, and Toxic−Waste Cleanup , 50 Law & Contemp. Probs. 119 (1987).] Professor Carlson's argument begins with some obvious but overlooked gems of the law. [*FN:* See id. at 119 (discussing lack of development and consideration of foreclosure theory).] He notes that the purpose of a lien is to generate cash proceeds from the sale of specific property so that the creditor holding the lien may collect on the debt. [*FN:* See id , at 142.] Obviously, the lien cannot alone serve that function; rather, this purpose cannot be accomplished without foreclosing the enforcing creditor's lien. According to Professor Carlson:

whether bankruptcy trustees should be able to foreclose contractually created running covenants . . . is another matter. The whole idea of running covenants on real estate is to prevent disencumberance by sale. If section 363(f) of the Bankruptcy Code were read easily to authorize the destruction of servitudes, private land−use planning could be defeated by the bankruptcy of any participating landowner.

Nevertheless, section 363(f)(5) of the Bankruptcy Code could be used to foreclose such servitudes if servitude owners can be forced to accept cash in lieu of injunctive relief at state law. The trustee could then disencumber the land from servitudes, sell the land for its unencumbered value, demote the servitude creditors (if they are unsecured) to a low priority, and pay them a few cents on the dollar. [*FN:* See id. (citations omitted).]

Professor Carlson further notes that a sale free and clear of restrictions and covenants would convert the third party

into a creditor of the bankruptcy estate. It does not follow, however, that the creditor would be unsecured. In fact, the creditor's interest in the property is entitled to adequate protection under section 363(e). [*FN:* 11 U.S.C. § 363(e) (1994) (empowering court to prohibit or condition sale of debtor's property to protect interest of creditor).] Taken in this context, adequate protection usually means that the interest in the property attaches to the proceeds of the sale, a simple substitution of property. [*FN:* See id ;*In re* Collins, 180 B.R. 447, 452 (Bankr. E.D. Va. 1995) (ordering liens to attach to proceeds of sale in order to provide adequate protection to secured creditor's interest).] In reading Professor Carlson's discussion one must carefully note what he did not say: he did not conclude that the disencumberance of covenants under section 363(f) was prohibited by the statute itself.

III. WHY SALES FREE AND CLEAR OF RESTRICTIONS AND COVENANTS ARE PERMITTED

In this Part, the article develops the argument that the sale of property of the estate free and clear of restrictions is and should be authorized under the Bankruptcy Code. The position defended in this article is consistent both with the language of section 363 itself and the policies embodied in the Bankruptcy Code. This Part provides a critical analysis of the various grounds on which bankruptcy courts may and should authorize such sales in appropriate situations.

A. Plain Meaning Approach − Language of Section 363 Itself

Section 363(f) of the Bankruptcy Code specifically provides that "[t]he trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate. . . ." [*FN:* 11 U.S.C. § 363(f).] Section 363(f) goes on to set forth limitations. [*FN:* See id. § 363(f)(1)−(5); see also supra notes 8−9 and 36 and accompanying text.] However, a careful reading of section 363, would lead one to realize that it is difficult to imagine a situation where the requirements of these limitations cannot be met by the trustee.

The first obstacle the trustee must overcome in an attempt to sell property free and clear of equitable servitudes or real covenants requires the trustee to establish that equitable servitudes or real covenants fall within the term "any interest" as found in section 363(f). [*FN:* See 11 U.S.C. § 363(f).] Though not universal, a lone line of precedent exists in which courts have repeatedly found servitudes and covenants to constitute interests in land. [*FN:* See Gouveia v. Tazbir, 37 F.3d 295, 298 (7th Cir. 1994) (agreeing with bankruptcy court in noting that "although restrictive covenants . . . may contain the characteristics of both a contract and an interest in real estate, the primary nature of such covenants is not contractual but rather a property interest") (citation omitted); United States v. Evans, 844 F.2d 36, 41 n.1 (2d Cir. 1988) (stating that "we recognize that restrictive covenants may create non−possessory interests in land"); Adult Group Properties, Ltd. v. Imler, 505 N.E.2d 459, 464 (Ind. Ct. App. 1987) (noting that "restrictive covenant creates a property right in each grantee and subsequent grantees") (citation omitted); Stamford v. Vuono, 143 A. 245, 249 (Conn. 1928) (noting restrictive covenants "are in the nature of an easement, constituting an interest in the land upon which they are imposed") (citations omitted).] The trustee likewise should be able to show that such sale is permitted even with the limitations imposed by section 363, specifically with respect to subsections (f)(1), (3), and (5). [*FN:* I have assumed that § 363(f)(2) will not be satisfied because I have assumed that the entity other than the estate that has an interest in the property will not consent to such sale, and that § 363(f)(4) will not be satisfied because I have assumed there is not a bona fide dispute regarding the restriction.]

1. Section 363(f)(1) − "Changed Conditions"

Section 363(f)(1) permits the sale free and clear of any interest if "applicable nonbankruptcy law permits sale of such property free and clear of such interest." [*FN:* 11 U.S.C. § 363(f)(1).] Virtually every jurisdiction's real property laws permit the voidance of, or hold as unenforceable, servitudes and covenants against the encumbered land under the doctrine commonly referred to as "changed conditions." [*FN:* Injunctive relief against the violation of the obligations arising out of a covenant is not available "if conditions have so changed since the making of the promise as to make it impossible longer to secure in a substantial degree the benefits intended to be secured by the performance of the promise." Restatement (First) of Property , § 564, at 3311 (1944).] Typically, however, courts will refuse to extinguish the covenants or servitudes under the doctrine of changed conditions if a parcel of land is perceived to be continuing to enjoy the benefit of the restrictions. [*FN:* See Western Land Co. v. Truskolaski, 495 P.2d 624, 626 (Nev. 1972) (providing that commercialization in vicinity of protected subdivision did not render covenants restricting such subdivision to single−family dwellings unenforceable because they were still valuable to homeowners in subdivision) (citations omitted); West Alameda Heights Homeowners Ass'n v. Board of County Comm'rs., 458 P.2d 253, 256 (Colo. 1969) (upholding restriction prohibiting commercial use because restriction was beneficial to home owners); see also Deak v. Heathcote Ass'n, 595 N.Y.S.2d 556, 557 (App. Div. 1993) (noting that plaintiff seeking to extinguish restrictive covenant must demonstrate lack of benefit derived

from enforcement of restriction and legally cognizable reason for extinguishment of restriction, such as changed conditions which render purpose of restriction incapable of being accomplished) (citations omitted).] "As long as the original purpose of the covenants can still be accomplished and substantial benefit will inure to the restricted area by their enforcement, the covenants stand even though the subject property has a greater value if used for other purposes." [*FN:* West Alameda Heights , 458 P.2d at 256.] Increased value alone is not enough to warrant refusal to enforce the restriction. [*FN:* See, *e.g.* , Texas Co. v. Harker, 129 A.2d 384, 391 (Md. 1957) (discussing factor of increased economic benefit to owners need not be ignored but also finding factor was not controlling). Cf. Welshire v. Harbison, 91 A.2d 404, 406−07 (Del. 1952) (noting that mere change in economic conditions rendering it unprofitable to continue development subject to original restriction was not in itself change sufficient to justify abrogating restrictive covenant) (citations omitted).] The fact that the subject property is in the bankruptcy estate is insufficient in itself to establish "changed conditions." [*FN:* See Rombauer v. Comptom Heights Christian Church, 40 S.W.2d 545, 553 (Mo. 1931) (stating that in order to defeat purpose of restriction, changed conditions must be so radical so as to destroy essential purpose of agreement); see also Grossbaum v. Dil−Hill Realty Corp., 395 N.Y.S.2d 246, 247 (App. Div. 1977) (noting that party seeking to extinguish restriction on ground of changed condition must establish that property was both valueless and enforcement of restriction was onerous).] The change must be examined from the perspective of the benefitted properties, *i.e.* from the entity other than the estate holding an interest in the debtor's property.

One of the most difficult tasks courts face in resolving cases dealing with changed circumstances is defining the "restricted area." [*FN:* See generally , Powell and Rohan , supra note 65, & 679[2], at 60−143.] The trustee nonetheless, may prevail under this limitation if the trustee is successful in persuading the court that the "restricted area" must be viewed in its totality, *i.e.*, even if one individual parcel continues to receive the benefits, the restricted area as a whole does not. This may be pertinent in many situations, such as in the story introduced in Part I of the article. [*FN:* See supra Part I.] Recall that the majority of the restricted area in the story was unsalable as restricted, and only a small percentage received the benefit. (Even then, under the hypothetical it is questionable whether these parcels were receiving any benefit from the restrictions other than the blackmail holdout impact garnered by the trash collection company refusing to voluntarily release the restrictions.) Looking at the "restricted area" as a whole, a court may indeed determine that the "restricted area" does not derive substantial benefit and may render the covenants void. Such determination is in essence selling the property to the current owner free and clear of such interest pursuant to applicable nonbankruptcy law.

The changed conditions doctrine is accepted by *Restatement of Property* section 564. [*FN:* Restatement (First) of Property , supra note 131, § 564, at 3311.] However, comment (d) of the *Restatement* states that denial of an injunction because of changed conditions does not extinguish the obligation and does not foreclose an award of damages for breach of covenant. [*FN:* See id . § 564 comment (d).] The damages remedy for breach of a restrictive covenant likewise has the backing of some commentators when multiple parties have the benefit of covenant, making voluntary release impracticable. [*FN:* See Curtis J. Berger, Some Reflections on a Unified Law of Servitudes , 55 S. Cal. L. Rev. 1323, 1330−31 (1982) (discussing that availability of permanent damages would eliminate outcomes in which losers lose everything and would lead to termination of doctrines such as changed conditions); cf. Uriel Reichman, Toward a Unified Concept of Servitudes , 55 S. Cal. L. Rev . 1177 (1982) (proposing that servitude treatments should be extended only to conditions that were intended to benefit land).]

In some jurisdictions, the trustee would have a much easier time establishing that the doctrine of changed conditions meets the requirement that nonbankruptcy law permits the sale of such property free and clear of such interest pursuant to section 363(f)(1). [*FN:* 11 U.S.C. § 363(f)(1) (1994).] For example, Massachusetts makes damages rather than injunctions the only remedy in some cases. Under Massachusetts law, "[n]o restriction shall in any proceeding be enforced or declared to be enforceable . . . unless it is determined that the restriction is at the time of the proceeding of actual and substantial benefit to a person claiming rights of enforcement." [*FN:* Mass. Gen. Laws Ann . ch. 184, § 30 (West 1991).] Further, even if a restriction is found to be of such benefit, it is not enforced except by award of money damages if any of several enumerated conditions are found to exist. [*FN:* See id .] Those conditions include:

(4) continuation of the restriction on the parcel against which enforcement is claimed or on parcels remaining in a common scheme with it or subject to like restrictions would impede reasonable use of land for purposes for which it is most suitable, and would tend to impair the growth of the neighborhood or municipality in a manner inconsistent with the public interest or to contribute to deterioration of properties or to result in decadent or substandard areas or blighted open area, or (5) enforcement, except by award of money damages, is for any other reason inequitable or not in the public interest. [*FN:* Id . § 30(4), (5).]

Applying Massachusetts law to the facts in our story, one could conclude that the property could be sold free of the restriction under applicable nonbankruptcy law because enforcement of the restriction would either impede reasonable use of the land for the purposes for which it is most suitable, or be inequitable and not in the public interest.

2. Section 363(f)(3) − Restriction is within the Definition of "Lien"

under the Bankruptcy Code

Section 363(f)(3) permits a trustee to sell property under subsection (b) or (c) free and clear of any interest in such property of an entity other than the estate if such interest is a lien and the price at which "such property is to be sold is greater than the aggregate value of all liens on such property." [*FN:* 11 U.S.C. § 363(f)(3).] The question then becomes, is a restrictive use covenant a lien?

Although counterintuitive, the language of section 101(37) of the Bankruptcy Code seems to indicate that a restrictive use covenant is indeed a lien. Pursuant to section 101(37), "lien" is defined to mean a "charge against or *interest* in property to secure payment of a debt *or performance of an obligation*." [*FN:* Id . § 101(37) (emphasis added).] A restrictive use covenant, such as the one at issue in *Gouveia* [*FN:* Gouveia v. Tazbir, 37 F.3d 295, 297 (7th Cir. 1994) (involving covenant restricting use of land to residential purposes).] or in the story in Part I of the article, [*FN:* See supra text accompanying notes 15−27 (discussing covenant restricting land use to industrial purposes).] is precisely an interest to secure performance of an obligation. [*FN:* But see *In re* 523 E. Fifth St. Hous. Preservation Dev. Fund Corp., 79 B.R. 568, 570 (Bankr. S.D.N.Y. 1987); supra notes 45−68 and accompanying text (discussing 523 E. Fifth St.). The court concluded, without analysis of the Bankruptcy Code's definition, that a restrictive covenant requiring property be used only for low−income housing was not a lien. See 523 E. Fifth St. , 79 B.R. at 570.] In *Gouveia*, the neighbors, who objected to the construction of the music store, held an interest in the debtor's property (the use restriction) to secure performance of the obligation by the debtor that she would not construct a non−residential structure. [*FN:* Gouveia , 37 F.3d at 297.]

Having thus established that the restrictive use covenant fits within the definition of lien, the trustee need only demonstrate that the price at which the property is to be sold is greater than the aggregate value of all liens on such property. [*FN:* See 11 U.S.C. § 363(f)(3) (allowing property to be sold by trustee free and clear of restrictions if sold for greater than aggregate of all liens).] This requirement forces a valuation of the "lien" interest held by the beneficiaries of the restriction. Presumably, this valuation would be accomplished by establishing a fair market value of the neighbors' property with the benefit of the restriction, and a fair market value of the neighbors' property without the benefit of the use restriction. [*FN:* See, *e.g.* , Stamford v. Vuono, 143 A. 245, 249 (Conn. 1928) (establishing value of easement as "depreciation in the market value of the dominant tenement . . . shown by the difference in the fair market value of the property before and after the taking") (citation omitted).] The difference would constitute the value of the lien. [*FN:* See id.]

It is unclear in *Gouveia* whether or not the trustee could meet this burden, since we do not know how many neighbors benefitted from the "lien" or the aggregate

value of all of the liens. In the event there existed a large number of beneficiaries, the aggregate value of their liens may indeed exceed the price at which the property was to be sold. In that instance, the trustee would have no incentive to market the property in such a fashion since the neighbors' claims would attach to all the proceeds of the sale, with no benefit to the estate by selling the property free and clear of the lien. [*FN:* 11 U.S.C. § 554(a). Instead of selling the property, the trustee may elect to abandon the property under § 554. *Id.*] Nonetheless, courts should recognize the trustee's ability to explore this option.

In the story set forth in Part I, the sale of the 2,000 acres free of the "lien" held by Re−Movall would, in all likelihood, be beneficial to the estate. [*FN:* See supra Part I.] Such a sale would also be the best option for the trustee. Recall that the trustee in the story could sell the property for $10,000/acre (totaling $20 million), if the property could be used for residential purposes. The only other beneficiary of the restriction other than the debtor was the trash collection company, which owned a mere four acres. If we assume that the loss of the benefit of the restriction for these four acres caused a decline in value by as much as the full value of the four acres, this still amounts to only $40,000 (assuming Re−Movall's land is also worth $10,000 per acre). In this event, the trustee would sell the adjoining land free of the restriction, the interest of Re−Movall would attach to the first $40,000 of the proceeds of the sale, and the

remainder would be available for distribution to creditors. [*FN:* 11 U.S.C. § 363(e); see supra notes 130−31 and accompanying text.] Thus, maximization of the estate has been accomplished without harm to the other entity holding an interest in the debtor's property, and one central policy of the Bankruptcy Code has been fulfilled.

3. Section 363(f)(5) − Can Compel Holder of Interest to Accept Money Satisfaction

Section 363(f)(5) permits the trustee to sell property free and clear of any interest in such property of an entity other than the estate if such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest. [*FN:* 11 U.S.C. § 363(f)(5).] Because the other entity could be compelled, in a condemnation action, to accept a money satisfaction for their interest, a trustee should be able to meet this limitation. [*FN:* See id.]

In order to sell the property free of the restriction, section 363(f)(5) does not require that either the trustee be the one able to compel the other entity to accept the money satisfaction, or that the other entity be actually compelled to have accepted the money satisfaction before the section 363 sale can take place. [*FN:* See id. The relevant statutory language is: "such entity could be compelled, in a legal or equitable proceeding , to accept a money satisfaction of such interest." *Id.* (emphasis added). It does not say "the entity could be compelled by the trustee " or "the entity could be compelled, in a bankruptcy proceeding ."] The language of section 363(f)(5) only requires that it be theoretically possible. [*FN:* 11 U.S.C. § 363(f)(5).]

It is well established that agencies possessing condemnation authority can, through eminent domain actions, acquire property over the owner's objection to selling. [*FN:* See id .] It is also settled that "the Government may take such lands (cleared, of course, of the burden of the covenants of the grant). . . ." [*FN:* United States v. 4.105 Acres of Land in Pleasanton, 68 F. Supp. 279, 289 (N.D. Cal. 1946).] The condemning authority that acquires the property will not be burdened by any previously imposed private restriction, [*FN:* See Dothan Area Chamber of Commerce Inc. v. Shealy, 561 So. 2d 515, 518 (Ala. 1990); see generally Powell & Rohan , supra note 65, & 679[4], at 60−153.] and no restriction is superior to the right of eminent domain. [*FN:* See McLean v. Thurman, 273 S.W.2d 825, 830 (Ky. 1954) (stating that "reasonable restriction may further, rather than oppose, public policy, and of course no restriction is superior to the right of eminent domain.").]

Generally, the only limitations on the ability of the condemning authority is that the condemnation be for a public use and that it pay just compensation for the interest taken. [*FN:* See U.S. C onst . amend. V; Powell & Rohan , supra note 65, & 679[4] at 60−153. There is disagreement among the jurisdictions whether the owner of the benefit of the restriction is even entitled to compensation. *Id.* The majority of the jurisdictions maintain the benefit of the restriction is a property right, and thus the owner is entitled to compensation. *Id.* A substantial minority, however, refuse compensation, reasoning that the restriction is a mere contract right and no "interest" has been taken. *Id.*] By paying just compensation, the condemning authority has compelled the interest holder, in a legal or equitable proceeding, to accept a money satisfaction of their interest.

The laws of eminent domain qualify as applicable nonbankruptcy law that permits a sale of such property free and clear of such interest. [*FN:* See Dothan , 561 So. 2d at 518 (stating that in acquiring land through eminent domain, condemning authority takes it free from burden of covenants).] Thus, the trustee is authorized under section 363(f)(1) to sell the property free and clear of equitable servitudes and restrictive covenants. [*FN:* 11 U.S.C. § 363(f)(1) (1994).] Even if the public body with the authority to condemn, acquired the property by purchase instead of through eminent domain proceedings, the sale would be construed nonetheless, as free of the restrictions. [*FN:* See Ryan v. Town of Manalapan, 414 So. 2d 193, 197 (Fla. 1982) (stating that "regardless of whether the arrangement can be regarded as involving a purchase, there is by virtue of the agreement an acquisition of property by a local government for public purposes.").]

Opponents to the trustee's motion may argue that the condemnation argument proves too much, and makes section 363(f)'s alleged limitations superfluous. In essence, the opponent would be saying the section doesn't mean what it says. The trustee's response − maybe not, but it still says what it says.

B. Policy Approach

By its very language, section 363(f)(5) permits the sale of property of the estate free and clear of restrictions. [*FN:* 11 U.S.C. § 363(f)(5); see supra notes 157−68 and accompanying text.] In this section, the article will demonstrate that this reading of section 363(f) is not only technically correct, but also promotes fundamental policies embodied in the present Bankruptcy Code. [*FN:* See H.R. Rep. No. 95−595, at 345 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6301−02.] Furthermore, this reading is no more offensive to third parties than other well−accepted present practices under section 363. [*FN:* See 11

U.S.C. § 363(g), (h) (referring to dower or curtesy rights or tenants in common, joint tenants or tenants by the entirety).]

One historical function and modern justification of bankruptcy law is that the collective proceeding maximizes the value of the debtor, reduces costs in administration, and increases the return for creditors of the estate. [*FN:* See 1 Bankr. Serv. L. Ed. § 1:2, at 16−17 (1994); see also H.R. Rep. No. 95−595, at 5 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 5966.] Section 363 embodies the spirit and the flesh of creditor wealth maximization. By employing its powers under section 363, a trustee may convert estate assets into cash in order to benefit estate creditors. [*FN:* 11 U.S.C. § 363(b), (c).] As previously discussed, section 363 is designed to permit a sale even at the expense of disencumbering competing interests in the asset. [*FN:* See id. § 363(g), (h); Veltman v. Whetzal, 93 F.3d 517, 520 (8th Cir. 1996) (finding co−owners given sufficient notice that their interests would terminate upon sale of property).] The Bankruptcy Code accomplishes this task in an elegant fashion; the Code converts the competing interests in the asset into allowable claims against the bankruptcy estate most often secured by the proceeds of the sale. [*FN:* See 11 U.S.C. § 363(e); Cambron Tool Co. v. Manufacturers Bank of Detroit (*In re* Cambron Corp.) 27 B.R. 723, 727 (Bankr. E.D. Mich. 1983) (attaching tax lien to proceeds of sale free and clear of lien).]

Permitting sales free and clear of restrictions is consistent with this model of section 363. Stripping the property free of restrictions will increase the value of the asset for the benefit of the creditors as a class. [*FN:* It is clear that if the value of the property would not increase once the restrictions are disencumbered, then a trustee would not seek their disencumberance in the first instance. The fact that these restrictions deflate the value of the property is the reason that the issue must be addressed.] Consider the example discussed in Part I of this article. [*FN:* See supra notes 15−27 and accompanying text (addressing authors' hypothetical fact pattern).] The trustee for Developer cannot sell the land as presently restricted for anything near its potential value while encumbered by the restriction. Without the restriction, the value of the property substantially increases so that the creditors may be paid in full.

To be sure, maximization of asset value and the increased return to creditors as a class is extracted, in part, from those holding the benefit of the restriction. So what else is new? The maximization of assets for the benefit of unsecured creditors often comes at the expense of third parties. [*FN:* Accord Carlson, supra note 2, at 1.] Technically, in this case, the Bankruptcy Code does not reduce the value held by those benefitting from the restriction but converts an interest in the land measured by the restriction into a claim against the estate. [*FN:* See 11 U.S.C. § 363(e) (providing for adequate protection of interest facing disencumberence); Veltman , 517 F.3d at 520−21 (discussing issue of valuation of interest after sale of property free and clear of interests); *In re* WPRV−TV Inc., 143 B.R. 315, 319 (D.P.R. 1991) (attaching secured portion of property sold, to proceeds of sale). Furthermore the violation of a restriction fits well within the all−encompassing meaning of "claim" under the Bankruptcy Code. See 11 U.S.C. § 101(5) (1994).] Viewed in this light, section 363(f)(5) provision concerning sale free of restrictions is no different than the sale free of monetary liens. Granted, the former sale poses more difficult valuation issues, but there exists a rich history of valuing the disencumberance of restrictions in the eminent domain context from which a bankruptcy court may draw. [*FN:* See United States v. Welch, 217 U.S. 333, 339 (1910) (valuing loss of easement as reduction of value of affected property); Brooklyn East. Dist. Terminal v. City of New York, 139 F.2d 1007, 1011−13 (2d Cir.) (assessing value of freight terminal's exclusive right to operate on land) *cert. denied* , 322 U.S. 747 (1944); American Tel. & Tel. Co. v. Madison Parish Police Jury, 465 F. Supp. 168, 170 (W.D. La. 1977) (measuring compensation as cost of relocation of right of way); Lee v. Atlanta, 219 Ga. App. 264, 267 (Ct. App. 1995) (finding proper damages as difference between market value before and after taking).] Thus, the slogan that land is unique and, therefore, no adequate remedy at law exists rings hollow; the government has the power to force the sale of the restriction at a fair price. [*FN:* See supra notes 157−68 and accompanying text.]

Furthermore, a section 363 sale free and clear of restrictions is not as offensive as other sales explicitly permitted under section 363. [*FN:* 11 U.S.C. § 363(g), (h).] For example, section 363(g) permits a sale free and clear of vested or contingent dower or curtesy rights. [*FN:* See id. § 363(g).] Additionally, section 363(h) permits a sale free and clear of co−ownership rights in the property. [*FN:* See id. § 363(h).] In light of the language of section 363(f) and the furtherance of recognized, well−accepted bankruptcy policy, an equitable argument by the holders of the benefits of restrictions is not as compelling as the widow or widower asserting dower or curtesy rights.

Finally, a construction of section 363(f) permitting a sale free and clear of restrictions is consistent with the efficient breach doctrine. [*FN:* See Northwest Airlines Inc. v. United States Dep't of Transp., 15 F.3d 1112, 1121 n.5 (D.C. Cir. 1994) (defining efficient breach as concept that breaching party has option of paying contractual obligations where damages are adequate substitute for specific performance). See generally Restatement (Second) of Contracts ch. 16 reporter's note at 101−02 (1981).] Neoclassical economic theory states that a voluntary exchange generally reallocates finite resources from less to more valuable uses. [*FN:* See Restatement (Second) of Contracts , supra note 185, at 101.] However, subsequent circumstances may alter the values of

competing uses and make the contracted−for exchange inefficient. [*FN:* See id.] Thus, changed circumstances make performance inefficient. [*FN:* See id.] Forcing the property owner (the trustee in the example in this article) to perform where its opportunity costs exceed damages for breach of opportunity produces a deadweight loss. [*FN:* See Carlson, supra note 119, at 143 n.109 for a brief discussion on the application of the efficient breach doctrine to servitudes. Professor Carlson does not favor the application of the efficient breach doctrine to restrictions in bankruptcy proceedings partly because under his reading of § 363 the servitude owners would become general unsecured creditors. However, § 363(e) provides that the court will prohibit or condition such sale to provide adequate protection to the entity other than the debtor that has an interest in the property to be sold. Most often, the form of adequate protection will be to have the interest attach to the proceeds, thus avoiding Professor Carlson's concern of being converted to general creditors. See generally Ian R. Macneil, Efficient Breach of Contract: Circles in the Sky , 68 Va. L. Rev. 947 (1982).] Moreover, two recurring reservations endemic in the efficient breach theory are adequately addressed by the authorization of sales free and clear of restrictions. [*FN:* See Macneil, supra note 189, at 954−60 (noting that first reservation with efficient breach theory is that it ignores injured party's time and money expended in negotiation of contract and in later having to go to court and set expectation damages, otherwise known at transaction costs and second problem is valuation of breach); Restatement (Second) of Contracts , supra note 185, chap. 16 intro, at 100 (same).] First, the holder of the benefits of the restrictions may not be able to extract an inflated price for the value of the restriction. [*FN:* See 11 U.S.C. § 506(a) (leaving valuation up to discretion of bankruptcy judge).] The holders "hold−out" power is severely curtailed by the infusion of a third−party neutral in the valuation process)the bankruptcy judge. [*FN:* See id. (noting that determination of value of secured claims is made at hearing).] Second, the often glossed over assumption of payment for the breach becomes payment in fact where the holder receives a claim secured by the proceeds of the sale. [*FN:* See Cambron Tool Co. v. Manufacturers Bank of Detroit (*In re* Cambron Corp.), 27 B.R. 723, 727 (Bankr. E.D. Mich. 1983) (securing lien with sale proceeds).]

CONCLUSION

The notion of a bankruptcy trustee disencumbering restrictions and covenants through a sale of an estate asset free and clear under section 363(f) seems unfair. But several persuasive reasons exist, supporting such a construction of section 363(f), assuming that either section 363(b) or 363(c)(1) has been met. First, section 363(f) itself does not limit the type of interest in the property that may be disencumbered by the bankruptcy trustee. [*FN:* See 11 U.S.C. § 363(f) (stating "trustee may sell property . . . free and clear of any interest") (emphasis added).] Second, a covenantee may be compelled to accept money damages under existing law. [*FN:* See Christensen v. Tucker, 114 Cal. App. 2d 554, 559 (Cal. Dist. Ct. App. 1952) (stating general rule of awarding damages over injunctive relief).] Besides the fact that damage remedies exist for actions asserting a breach of a restrictive covenant enforceable at law, the government through its power of eminent domain may

compel the covenantee to accept money damages. [*FN:* See supra notes 157−68 and accompanying text (discussing eminent domain, forcing acceptance of money damages in exchange for sale of property free of restrictions).] Section 363(f) speaks in terms of compelling the third party and not in terms of who is doing the compelling.

A covenantee's equity argument should also fail. First, although such a sale most assuredly maximizes the return for creditors, it does so at the expense of those who benefit from and may enforce the covenant. After all, the argument goes, one should not benefit or receive a windfall from the mere "happenstance of bankruptcy." [*FN:* See Butner v. United States, 440 U.S. 48, 55 (1979) (quoting Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603, 609) (creating uniformity in treatment of property interest between state and federal courts).] But we know debtors receive both a benefit and a windfall from a bankruptcy filing. We also know that the principle purpose of bankruptcy law, to maximize assets of the estate for the benefit of unsecured creditors, is often achieved at the expense of some other entity. [*FN:* See Carlson, supra note 2 at 1.] Additionally, such a sale is not as offensive as sales free and clear of dower and curtesy rights [*FN:* 11 U.S.C. § 363(g).] or co−ownership interests. [*FN:* See id. § 363(h).] Finally, such sales are consistent with the efficient breach doctrine. Concerns with the application of the doctrine in the past are not present in this context)a neutral third−party will decide the value of the restriction and the nonbreaching party will be paid.