Amending and Terminating Perpetual Conservation Easements

By Nancy A. McLaughlin and Benjamin Machlis

Over the past several decades, landowners have donated perpetual conservation easements encumbering millions of acres to government entities and to charitable conservation organizations known as land trusts. Landowners make these charitable gifts for a number of reasons, including a desire to ensure the permanent protection of their land and to take advantage of tax benefits.

Until fairly recently, little consideration has been given to precisely what it means to protect land "in perpetuity" with a conservation easement. But as perpetual conservation easements have begun to age, and the protected lands have begun to change hands, questions have arisen regarding the circumstances under which these instruments can be amended or terminated.

This article outlines the current guidance on this issue and offers some drafting suggestions. Because of space constraints, it focuses on perpetual conservation easements donated to land trusts or state and local government entities, in whole or in part, as charitable gifts and for which the donor claims or could claim federal tax benefits (tax-deductible conservation easements). This article is not intended to imply that conservation easements conveyed in other contexts will not be subject to the same or similar equitable principles.

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Conservation Easements as Charitable Trusts

A number of sources indicate that tax-deductible conservation easements will be treated as charitable trusts under state law and, thus, that such easements can be terminated, or amended in a manner contrary to their charitable conservation purposes, only in *cy pres* or similar equitable proceedings.

Restatements and Uniform Laws

Comment a to section 28 of the Restatement (Third) of Trusts (2003) provides that a gift made to a charitable institution to be used for a specific charitable purpose, as opposed to the institution's general purposes, creates a charitable trust of which the institution is the trustee. This principle also generally applies to gifts made for specific charitable purposes to state and local government entities. Tax-deductible conservation easements are donated in whole or in part to government entities and land trusts to be used for a specific charitable purpose—the protection of the particular land encumbered by the easement for one or more of the conservation purposes enumerated in the Code

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in perpetuity (all references herein to the Code are to the Internal Revenue Code of 1986, as amended). Accordingly, the donation of a tax-deductible conservation easement should be treated as creating a charitable trust of which the acquiring entity is the trustee.

In some jurisdictions, courts refer to gifts made to government or charitable entities to be used for specific charitable purposes, not as charitable trusts, but as implied trusts, quasi-trusts, restricted charitable gifts, or public trusts. Regardless of the term used, the substantive rules governing the administration of charitable trusts (including *cy pres*) generally apply, although some procedural rules applicable to formal trusts (such as those relating to accountings) do not.

The Uniform Conservation Easement Act (UCEA) is consistent with the Restatement (Third) of Trusts. The UCEA was approved by the Uniform Law Commission (ULC) in 1981 and has been adopted by 24 states and the District of Columbia. Although UCEA § 2(a) provides that a conservation easement may be modified or terminated "in the same manner as other easements" (that is, by agreement of the holder of the easement and the owner of the encumbered land), section 3(b) states that "[t]his Act does not affect the power of a court to modify or terminate a conservation easement in accordance with the principles of law and equity." In the comment to section 3, the drafters explained that the UCEA leaves intact the existing case and statutory law of adopting states as it relates to the modification and termination of ea - ments *and* the enforcement of charitable trusts and that, independent of the UCEA, the state attorney general could have standing to enforce a conservation easement in his capacity as supervisor of charitable trusts. In other words, the UCEA does not and was never intended to abrogate the well-settled principles that apply when property, such as a conservation easement, is conveyed as a charitable gift to a government or charitable entity to be used for a specific charitable purpose.

To confirm its intention that conservation easements be enforced as charitable trusts in appropriate circumstances, the ULC amended the comments to the UCEA in 2007. The amended comments provide that, because conservation easements are conveyed for specific charitable purposes, the existing case and statutory law of adopting states as it relates to the enforcement of charitable trusts should apply to conservation easements. The comments also provide that, notwithstanding UCEA § 2(a), the entity holding a conservation easement, in its capacity as trustee, can be prohibited from agreeing to terminate the easement (or modify it in contravention of its purpose) without first obtaining court approval in a *cy pres* proceeding.

The Uniform Trust Code (UTC) was approved in 2000 and has been adopted by 20 states and the District of Columbia. Like the UCEA, the comments to the UTC (§ 414) provide that the creation and transfer of a conservation easement will frequently create a charitable trust; the organization to which the easement is conveyed will be deemed to be acting as trustee of what will ostensibly appear to be a contractual or property arrangement; and, because of the fiduciary obligation imposed, the termination or substantial modification of the easement by the trustee can constitute a breach of trust. The comments to the UCEA and the UTC are likely to be relied on as a guide in interpreting those acts so as to achieve uniformity among the states that have enacted them.

Finally, section 7.11 of the Restatement (Third) of Property: Servitudes (2000) provides that the modification and termination of conservation easements should be governed, not by the real property law doctrine of changed conditions, but by a special set of rules based on the charitable trust doctrine of *cy pres.* In their commentary, the drafters explain that, because of the public interests involved, these servitudes are afforded more stringent protection than privately held conservation servitudes.

Federal Tax Law

Under federal tax law, the gift of a tax-deductible conservation easement must effectively be in the form of a restricted charitable gift or charitable trust.

- The easement must be conveyed as a charitable gift to a government or charitable entity for a specific charitable purpose—the protection of the particular land encumbered by the easement for one or more of the conservation purposes enumerated in the Code in perpetuity. See generally Code § 170(h); Treas. Reg. § 1.170A-14.
- The easement must be expressly transferable only to another qualified entity that agrees to continue to enforce the easement. See Treas. Reg. § 1.170A-14(c)(2).
- The easement must be extinguishable by the holder only in what essentially is a *cy pres* proceeding—in a judicial proceeding, upon a finding that the continued use of the land for conservation purposes has become "impossible or impractical," and with the payment of a share of the proceeds from the subsequent sale or development of the land to the holder to be used for similar conservation purposes. See id. § 1.170A-14(g)(6).
- The interest in the land retained by the donor must be subject to legally enforceable restrictions that prevent any use of the land inconsistent with the easement's purpose. See id. § 1.170A-14(g)(1). r
- At the time of the donation, the possibility that the easement will be defeated must be so remote as to be negligible. See id. § 1.170A-14(g)(3).

Because federal tax law contemplates that conservation easements will be extinguished only in *cy pres* proceedings (or through condemnation), Congress is apparently relying on state charitable trust law for the enforcement of such easements over the long term. This reliance is appropriate. The regulation of the behavior of charitable fiduciaries is principally a state, rather than a federal, function. State judges and attorneys general have the greatest expertise in disputes involving nonprofit governance and fiduciary responsibilities, and state courts, rather than the

Tax Court or the IRS, possess the broad range of equitable powers necessary to protect assets dedicated to charitable purposes. In fact, state attorneys general are increasingly recognizing their right and obligation, as supervisors of charitable gifts and trusts, to enforce conservation easements on behalf of the public.

Cases and Controversies

A number of cases and controversies also indicate that conservation easements are likely to be treated as restricted charitable gifts or charitable trusts under state law.

- *In re Preservation Alliance for Greater Philadelphia,* O.C. No. 759 (Ct. Com. Pl. of Philadelphia County, Pa. June 28, 1999), the court applied the doctrine of *cy pres* to authorize termination of a perpetual façade easement encumbering an historic building after finding that the building could not be restored to any proper use.
- In Consent Judgment, *State v. Miller,* No. 20-C-98-003486 (Md. Cir. Ct. July 16, 1999), the court approved the settlement of a suit involving the attempted "amendment" of a perpetual conservation easement encumbering a 160-acre historic tobacco plantation located on the Maryland Eastern Shore to allow a seven-lot upscale subdivision on the property. The state attorney general had filed suit asserting that the easement constituted a charitable trust that could not be amended as proposed without receiving court approval in a *cy pres* proceeding. As part of the settlement, the landowner and easement holder agreed that any action contrary to the express terms and stated purposes of the easement was prohibited and that no action could be taken to amend, release, or extinguish the easement without the express written consent of the attorney general.
- *In final order *Tenn. Envtl. Council v. Bright Par 3 Assocs., L.P.,* No. 03-0775 (Ch. Ct. Hamilton County, Tenn., Dec. 19, 2006), the court approved the settlement of a suit involving a four-lane road constructed across land protected by a perpetual conservation easement to provide access to an adjacent Wal-Mart Supercenter. Two nonprofit organizations and a private citizen had sued the owner of the encumbered land (the development corporation that had sold the adjacent land to Wal-Mart) and the holder of the easement (the city of Chattanooga) objecting to the construction. In the settlement, the development corporation agreed to (1) convey a replacement parcel of land and $500,000 to the plaintiffs to be used for similar conservation purposes and (2) pay the plaintiffs' not insubstantial legal fees. In approving the settlement, the court concluded that the charitable purpose of the easement had become, in part, "impossible or impractical," and the property and cash transferred to the plaintiffs constituted a reasonable and adequate substitute for any portion of the property that may have been affected or taken as a result of the road construction.
- *Hicks v. Dowd,* 157 P.3d 914 (Wyo. 2007), involved a perpetual conservation easement encumbering an approximately 1,000 acre ranch located in Johnson County, Wyoming. A partnership had donated the easement to the county in 1993 and claimed a federal charitable income tax deduction of over $1 million. The partnership later sold the land, subject to the easement, to the Dowds. When the energy company that owned the minerals underlying the land and was not subject to the easement engaged in minimal drilling on the property, the Dowds persuaded the county to transfer the easement to them for the purpose of terminating the easement. A resident of the county (Hicks) sued, alleging that the county could not agree to terminate the easement without receiving court approval in a *cy pres* proceeding. In 2007, the Wyoming Supreme Court dismissed the case on the ground that Hicks did not have standing to sue to enforce a charitable trust but invited the state attorney general, as supervisor of charitable trusts, "to reassess his position" on the case. In July 2008, the attorney general filed a complaint in district court requesting that the deed transferring the conservation easement to the Dowds be declared null and void. The complaint alleged, among other things, that the county violated its fiduciary duty to assure the ranch's permanent protection and to have a judicial determination made of impossibility before terminating the easement. This case was still pending on the date of publication of this article.

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Amending Conservation Easements

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Charitable Trust Principles

Flexibility to modify conservation easements in manners consistent with their charitable conservation purposes is often

built into easements in the form of an amendment provision. The typical amendment provision grants the government or nonprofit holder the *express power* to agree to amendments that are consistent with or further the conservation purpose of the easement. Absent an amendment provision, the holder might be deemed to have the *implied power* to agree to certain amendments that are consistent with the purpose of the easement or could seek court approval of such "consistent" amendments in a more "exible *administrative (or equitable) deviation proceeding*. But the outright termination of a conservation easement, or its modification in a manner inconsistent with its stated purpose (such as to permit subdivision and development of the land), should require court approval in a *cy pres* or similar equitable proceeding (as is contemplated under federal tax law).

Federal Tax Laws

The requirement under Code § 170(h)(5)(A) that the conservation purpose of a tax-deductible easement be "protected in perpetuity" should establish the basic parameters for a permissible grant of amendment discretion to the holder. The conservation purpose of an easement would not be protected in perpetuity if the easement could be amended in manners that adversely affect or change such purpose. Alternatively, the conservation purpose of an easement would not be jeopardized if the holder is given the discretion to agree to only those amendments that further, or are consistent with, such purpose. No formal guidance has yet been issued, however, on permissible amendments to tax-deductible conservation easements. Accordingly, the typical amendment provision authorizes only amendments that are consistent with or further the conservation purpose of an easement and additionally provides that amendments may not adversely affect the qualification of the easement or the status of the holder under Code § 170(h). The type of amendment that would satisfy these requirements is, at this point, unclear.

In a 2005 report on The Nature Conservancy, the Staff of the Senate Finance Committee noted that modifications to tax-deductible conservation easements to correct ministerial or administrative errors are permitted. The Staff expressed concern, however, about "trade-off" amendments, which both negatively affect and further the conservation purpose of an easement but, on balance, are arguably consistent with or further such purpose. The Staff explained that the weighing of increases and decreases in conservation benefits is difficult to perform by the holder and to assess by the IRS.

Government entities and land trusts also must be mindful of the effect amendments may have on their ability to continue to accept tax-deductible conservation easement donations. To be considered an "eligible donee," an entity must "have a commitment to protect the conservation purposes of the donation" and "the resources to enforce the restrictions." Treas. Reg. § 1.170A-14(c)(1). Although the Treasury Regulations provide that a conservation group organized or operated primarily or substantially for one of the conservation purposes specified in Code § 170(h) (as most land trusts are) will be considered to have the requisite "commitment," and the donee need not set aside funds to enforce the easement, the IRS might nonetheless take the position that an entity that agrees to amend the conservation easements it holds in contravention of their conservation purposes is no longer an eligible donee. The IRS also might take the position that the conservation purposes of easements donated to such an entity are not "protected in perpetuity" as required under Code § 170(h)(5)(A).

Finally, private inurement or private benefit can occur when a charitable organization sells or exchanges its property for less than fair market value. Although no formal guidance on this topic has been issued, a land trust that agrees to amend a conservation easement in a manner that increases the value of the encumbered land and confers an economic benefit on the landowner would presumably violate the private inurement or private benefit prohibition and thereby trigger intermediate sanctions or jeopardize its tax-exempt status. States and subordinate government entities are generally subject to a similar prohibition on conveying public property to private individuals pursuant to state constitutions.

Easement-enabling Statutes

All 50 states and the District of Columbia have enacted some form of easement-enabling statute. Many states have adopted the provision in the UCEA that provides that a conservation easement can be modified or terminated "in the same manner as other easements." As discussed above, however, that language was not intended to abrogate the principles that apply when property, such as a conservation easement, is conveyed as a charitable gift to a government entity or charitable organization to be used for a specific charitable purpose. Accordingly, the entity holding a donated conservation easement should agree to modify the easement consistent with its stated purpose only in accordance with its express power to amend (as set forth in an amendment provision), in accordance with its implied power to amend, or with court approval obtained in an administrative deviation proceeding.

A few easement-enabling statutes provide that a conservation easement can be modified or terminated (or converted or diverted) upon satisfaction of certain conditions, such as the holding of a public hearing or approval of a public official. As with the UCEA, however, there is no indication that these statutes were intended to abrogate the principles that apply when property, such as a conservation easement, is conveyed as a charitable gift to be used for a specific charitable purpose. Moreover, if conservation easements could be amended or terminated upon satisfaction of only the conditions in a state's enabling statute, and those conditions are not consistent with the requirements set forth in Code § 170(h) and the Treasury Regulations, conservation easements conveyed in the state should not be eligible for federal tax incentives.

Bjork v. Draper

In *Bjork v. Draper*, 886 N.E.2d 563 (Ill. App. Ct. 2008), app. den., 897 N.E.2d 249 (Ill. 2008), the court invalidated amendments to a perpetual conservation easement that a land trust approved at the request of new owners of the encumbered land. The land trust argued that the state enabling statute, which provides that a conservation easement can be released by its holder, gave it the right to release or amend the easement at will, regardless of (1) the status of the easement as a tax-deductible perpetual charitable gift, (2) the easement's charitable purpose, which is to retain "forever" the scenic and open space condition of the grounds of an historic home, (3) provisions in the easement expressly prohibiting some of the activities authorized by the amendments, and (4) the provision in the easement requiring that the easement be extinguished, in whole or in part, only by a judicial proceeding. Although the court noted that the easement contemplated amendments, and that protecting the conservation purpose of an easement in perpetuity does not necessarily mean that the language of the easement can never be changed (the court explained that an easement could be amended to add land, which would most likely enhance the easement's purpose), the court concluded that "no amendment is permissible if it con"icts with other parts of the easement." The court was not presented with and, thus, did not address the argument that the conservation easement constitutes a restricted charitable gift or charitable trust, which may have afforded the court some "exibility to ratify amendments if any were consistent with the easement's purpose. The court did, however, properly hold that tax-deductible perpetual conservation easements may not be substantially amended or released by their holders at will.

Drafting Suggestions

Protecting Donor Intent

Many landowners donate conservation easements because they have a strong personal connection to their land and desire to see *that* land permanently preserved in the manner set forth in the easement. Although it is well settled that use of the word "trust" or "trustee" is not necessary to create a trust relationship, and conservation easements not containing such terms nonetheless should be treated as restricted charitable gifts or charitable trusts, to provide even greater assurance that the holder of a conservation easement will enforce the easement according to its carefully negotiated terms and stated purpose, the easement could explicitly tie the gift to charitable trust principles. For example, the easement could specifically provide that (1) it is conveyed to the donee as a charitable gift to be held in trust for the benefit of the public for the charitable purpose stated in the easement, (2) the donee can agree to amend the easement only as provided in the amendment provision, and (3) the donee can agree to terminate the easement, in whole or in part, only as provided in the termination provision, which should comply with the requirements of Code § 170(h) and the Treasury Regulations and reference the doctrine of *cy pres* or its equivalent under the relevant state's law.

The landowner's attorney also should (1) review the donee's amendment policies and procedures, (2) discuss with the donee the donee's interpretation of the standard amendment provision (for example, does the donee take the position that such provision grants it the right to agree to trade-off amendments or remove land from the easement's protections?), and (3) if the donee is a charitable organization, review the schedules to IRS Form 990 on which the donee was required to report the number of easements it modified or extinguished during the taxable year. The landowner also may wish to customize the standard amendment provision to, for example, preclude the donee from agreeing to amend the easement to increase the level of residential development permitted on the property, which the donee might view as a permissible component of a trade-off amendment.

Finally, the landowner's attorney should explore additional enforcement options, such as providing in the easement (1) that the landowner and his heirs or other family members have standing to sue the holder to redress a breach of trust or (2) for a "gift over" of the easement (and accompanying stewardship endowment) to another qualified entity in the event of such a breach.

Providing Flexibility

To provide the "exibility needed to respond to changing social, economic, and environmental conditions, government entities and land trusts should negotiate for the inclusion of a standard amendment provision in the conservation easements they accept. They should also discuss their amendment policies and procedures and their interpretation of the standard amendment provision with prospective easement donors so there is no confusion or misunderstanding regarding their intent to agree to amendments that are consistent with or further the conservation purpose of an easement. If a landowner refuses to grant the desired level of amendment discretion, the donee can decline to accept the easement. Alternatively, the donee can accept the easement knowing it has less discretion to agree to amendments than is granted in a standard amendment provision. Donees also should consider when it is (and is not) appropriate to protect land in perpetuity with a conservation easement. In appropriate circumstances, more "exible land protection tools, such as leases or management agreements, should be employed.

Conclusion

Lawyers assisting easement donors and donees should have a thorough understanding of the various laws that can affect the administration of perpetual conservation easements. Although the law in this area is still developing, much can be done to ensure that conservation easements are drafted to comply with all relevant laws, carry out the landowners' intent, and provide easement holders with the "exibility needed to administer easements consistent with their overall charitable conservation purposes in light of changing conditions. ■