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Key property rulings from the courts

Who pays the rent?

Court of Appeal approves "no caveat" clauses

Hundreds of lease and sublease agreements are signed in New Zealand every week – most without major dispute. But when the unexpected happens such as a sublessee going under, who pays? This question continues to be disputed in our courts.

Many who work with property leases will be aware of the common law rule that a sublease for a term of the same length or longer than the head lease will operate as an assignment of that lease.

For a number of years now, parties have sought to avoid an unwanted assignment of a head lease by breaking the term of the head lease into two lease periods, with a delay in between them. During the delay period, the assignee occupies the premises not as lessee but rather as beneficiary of a trust.

A recent Court of Appeal decision (*Gibbons Holdings Limited v Wholesale Distributors Limited* McGrath, Glazebrook and Chambers JJ) suggests that courts are prepared to look behind clear wording in the lease documentation to find the parties' "commercial purpose", even if that purpose is one the parties were hoping to avoid.

Background to the case

Gibbons Holdings Limited (Gibbons) leased premises under a head lease dated April 1982. In July 1991, Gibbons subleased the premises to G.U.S. Properties Limited. The terms of the sublease were:

- The lessee had the right to renew the term by giving notice.
- The parties acknowledged that they entered into the sublease on the basis that the sublessor would exercise its rights of renewal in the head lease.
- Upon expiry of the initial term of the sublease, the sublessor was to hold the premises on trust for the sublessee for the period of one day, with the sublessee paying rent and outgoings for that day.
- A clause stated: "It is the intention of the parties that two days following the expiry of the [sublease] the parties shall enter into a new lease of the premises for a period expiring on 31 October 2010."

In 1997, G.U.S Properties assigned its interest in the sublease to Wholesale Distributors Limited (Wholesale). The expiry date of this lease was stated as "31 October 2002 with a new lease being granted for a term expiring 31 October 2010".

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In 2000, Wholesale assigned its sublease to a company that became known as Rattrays Wholesale Limited (RWL).

The dispute between Gibbons and Wholesale arose in late 2002, when RWL went into receivership and the receiver stopped paying rent to Gibbons. This was just at the time that the new lease was expected to commence (1 November 2002), and Gibbons obviously wanted the rent paid by someone. Neither RWL nor G.U.S Properties were in a position to pay, so Gibbons looked to Wholesale.

The issue for the High Court to decide was whether Wholesale’s obligations under the sublease continued on after October 2002.

The arguments in the High Court

Gibbons’ primary argument was that, read as a whole, the correct interpretation of the sublease was that Wholesale agreed to lease the premises from 2002 to 2010.

On the other hand, Wholesale argued that the correct interpretation was that the term of its sublease was 12 years less one day and expired on 30 October 2002. Gibbons was to then hold the premises on trust for Wholesale for one day, and there was to be a new lease between Gibbons and Wholesale commencing on 2 November 2002 and expiring 31 October 2010.

If this argument was accepted, then Wholesale could not be liable to Gibbons beyond 31 October 2002.

The judgment in the High Court

The High Court dismissed Gibbons’ claim.

The judge held that the effect of the choice of the arrangements adopted by the parties was clearly to avoid an assignment of the head lease. The substance of the 30 October 2002 arrangement was that the original sublease expired and a new sublease was then entered into, to which Wholesale

was not a party and therefore under which it had no liability.

Gibbons appealed to the Court of Appeal.

Arguments in the Court of Appeal

Gibbons made substantially different legal arguments in this appeal. Wholesale did not object to the change in direction and the Court let Gibbons develop its new arguments.

The focus of Gibbons’ new argument was on the 1997 deed of assignment between it and Wholesale. Gibbons argued that, by virtue, *of this deed*, Wholesale became contractually bound to Gibbons to enter into the new lease and contractually committed to paying rent under it.

Wholesale disputed this interpretation and reiterated its High Court argument that its contractual obligations ceased when the sublease expired on 30 October 2002.

With the change in Gibbons’ case, the reasoning of both the judgments in the Court of Appeal naturally differed substantively from that of the High Court.

The reasoning of the majority

In a judgment delivered by Justice McGrath, the majority accepted the new arguments advanced by Gibbons, and made a declaration that Wholesale was bound to meet the obligations under the 1991 sublease, through to 31 October 2010.

They considered that the “crucial question” raised in the appeal was the meaning of the words “*the remainder of the term of the lease*”. In order to ascertain the intention of the parties, as expressed by that clause, the meaning of the words, in their context, must be ascertained. According to the majority, an “important part” of the context of the clause was its “commercial purpose”, and this could be found by the definition of “lease” in the 1997 deed of assignment.



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The First Schedule of the deed of assignment provided that "lease" meant the "Deed of Lease dated 10 July 1991". On this basis, the majority considered that the term concerned was for the whole of the lease period (i.e. from 1991 to 2010), not merely the first "of its three components".

The minority judgment

The reasoning of the majority was closely criticised by Justice Chambers in his minority judgment. His Honour considered the majority failed give effect to the arrangement that Gibbons and G.U.S Properties actually agreed. Justice Chambers considered that the majority's approach ignored the fact that the parties' relationship was intended to change at least twice during the 20 year period.

According to Justice Chambers, when the first lease came to an end in November 2002, so too did the relationship of landlord and tenant between Gibbons and Wholesale. That relationship changed to one of trustee and beneficiary for one or two days at the end of the first term. It then changed again under an agreement to lease, the proposed terms of the new lease being different from the terms of the first lease. In summary, His Honour considered that Wholesale's promise to Gibbons endured only until the end of the term of the sublease, that there was "no doubt" at all that the sublease expired on 30 October 2002, and that there was no contractual commitment between Gibbons and Wholesale beyond that date.

Our view

On balance, we prefer Justice Chambers' reasoning in this case. The analysis of the lease documents undertaken by the majority necessitates both a rewriting of the component documents and is incompatible with the express terms of those documents.

But regardless, the biggest lesson to be taken from the case is that it is crucial that parties seeking to avoid the application of a

common law rule such as the one at issue here, must be careful to spell out the purpose of the contract, and the extent of each party's liability, in no uncertain terms.

The *Gibbons v Wholesale* saga is also not yet over. Wholesale has very recently been granted leave to appeal to the Supreme Court. It will be interesting to see whether the Supreme Court backs the majority approach in the Court of Appeal, or that of the minority.

Court of Appeal overturns ruling on "no caveat" clauses

"No caveat" clauses contained in agreements for sale and purchase of land are common in the property development industry.

The prospective purchaser promises not to lodge a caveat against the title to the land and the developer retains the good title required to complete developments.

Last year the High Court held that these clauses were unenforceable on the basis that they are contrary to public policy. Those involved in property development will now be pleased to learn that the Court of Appeal has just delivered a judgment overturning this decision and upholding the enforceability of "no caveat" clauses.

The case

Landco Albany Limited (Landco) was the registered proprietor of land, approved by the local council for subdivision into 14 lots.

Landco entered into an agreement for sale and purchase with Fu Hao Construction Limited (Fu Hao) to sell the land subdivided in 53 lots, with Landco having the obligation to complete the subdivision.

Landco Albany experienced difficulty with obtaining the necessary resource consents, and purported to cancel the contract.

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In response, Fu Hao lodged a caveat over the land. Landco challenged the caveat, and Fu Hao sought an order under the Land Transfer Act 1952 that the caveat not lapse.

Among the issues for the High Court to consider – and the one upon which we focus in this article – is whether a “no caveat” clause appearing in the agreement prevented Fu Hao from protecting its arguable interest by caveat.

The clause stated:

"The Purchaser shall not lodge a caveat against the Vendor's title prior to deposit of the Vendor's Land Transfer Plan of Subdivision."

Fu Hao argued that this clause was unenforceable, and therefore did not prevent it from lodging, and upholding, a caveat.

The High Court decision

Fu Hao argued that the right to lodge a caveat was of a public rather than private nature, that the “no caveat” clause should be regarded as contrary to public policy and that therefore there was an implied prohibition on contracting out contained in the Act.

The High Court accepted this argument. It held that the “no caveat” clause was unenforceable, and sustained the caveat.

In coming to this view, the Court was influenced by the public and private benefits of land registration, stating that:

"The practical effect of the provisions is upon more parties than the caveator and registered proprietor. The public at large have the protection of knowledge available from search of the title; disputes are dealt with by the well tried statutory procedures without the need for recourse to the more

cumbersome general injunction procedures."

Landco then appealed to the Court of Appeal.

The Court of Appeal decision

In a judgment dated 30 November 2005, the Court of Appeal allowed the appeal, and ordered that the caveat was to lapse.

Crucially, the Court of Appeal did not accept the High Court's finding that “no caveat” clauses were unenforceable for reasons of public policy, instead stating:

"...the integrity of the system is not depreciated by declining to recognise a public policy invalidation of no caveat clauses and there are reasonable commercial and private reasons why such clauses may be stipulated and accepted".

Our view

We agree with the reasoning of the Court of Appeal in its move to overturn the High Court decision. There are often good reasons for “no caveat” clauses, and there should be no blanket prohibition on the ability to contract in such a way, if both the vendor and the purchaser so agree.

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