COVENANTS

Supreme Court upholds intention that easements and covenants can be modified and extinguished

BY **SUZANNE ROBERTSON QC**

Introduction

Section 317 Property Law Act 2007 (PLA) gives the court power to extinguish or modify an easement or covenant registered on the title to land. Applications for relief under the section have more than doubled in the second six years following the introduction of the 2007 Act on 1 January 2008 (2014 to 2019), compared to the first six years (2008 to 2013). This trend is likely to continue with the growth in migration, increasing pressure on land use and significant planning changes in New Zealand.

The Supreme Court's Judgment in *Synlait Milk Limited v New Zealand Industrial Park Limited* [2020] NZSC 157, restores confidence that Courts will properly assess such applications against the criteria set out in the section.

The Supreme Court restored the High Court's decision modifying covenants intended to assist the owner of the land benefitting from the covenants in any application for resource consent to establish a quarry. In doing so, the Supreme Court rejected the Court of Appeal's emphasis on the sanctity of contracts and resulting contractual property rights, saying the effect of the section was not to be restricted by judge made notions.

The Supreme Court's pre-Christmas judgment contains useful guidance on the approach to applications under s 317 generally and on some of the specific grounds in s 317(1), upon which a Court can decide to extinguish or modify a covenant or easement.

General guidance

After the hearing in the Supreme Court, the parties settled their dispute and requested that the Supreme Court not issue its judgment. The Court decided to deliver its judgment, despite the settlement, because the Court had heard full argument on the approach to be taken to applications under the section and, as the Supreme Court said, its views differed markedly in some respects from those of the Court of Appeal.

The power given to the Court in s 317 and its predecessors has been progressively broadened. The legislative history is set out in the Judgment. The Supreme Court recognised the broadening of the section and rejected the Court of Appeal's approach of overlaying the plain statutory wording with a reluctance to allow contractual property rights to be set aside. The Supreme Court emphasised that non statutory considerations, such as sanctity of contract, should not alter Parliament's clear intention that easements and covenants are amenable to modification or extinguishment in the circumstances set out in s 317.

Section 317 requires a balancing of policies and considerations in a two stage approach. The Court's first task is to determine whether one or more of the grounds in s 317(1) is made out. If so, the second task is to determine whether the discretion to extinguish or modify the easement or covenant at issue should be exercised (and, if so, to determine whether compensation should be payable). All relevant factors are to be weighed in considering the exercise of the discretion. The Supreme Court declined to provide any definitive list of relevant factors, as the relevant factors are likely to be different according to the facts of each individual case.

Having disagreed with the general approach taken by the Court of Appeal to the application, the Supreme Court went on to consider the particular grounds relied upon by the applicant for extinguishment or modification of the covenants at issue.

Background

The covenants, created in 1998 and 2000, restricted the use of the burdened land to farming, grazing and forestry operations in

order to protect the ability for the owners of the benefited land to develop a quarry on the benefited land. The covenants also contained clauses to the effect that the owner of the burdened land would not object to a quarry on the land or to any application for resource consent to establish a quarry.

At the time of the Supreme Court hearing, the burdened land (and part of the benefited land) was owned by Synlait Milk Limited (Synlait). The burdened land was referred to in the judgment (and in this article going forward) as the Synlait land. Synlait's purchase of the land from Stonehill Trustee Limited (Stonehill) had settled shortly after the Court of Appeal hearing and Synlait was substituted for Stonehill as applicant for the leave to appeal (and subsequent appellant) in the Supreme Court.

In its application, Stonehill had sought to extinguish the covenant, or in the alternative, to modify the covenant to delete the restriction that use of the burdened land must be confined to farming, grazing or forestry. Modification in this way would leave in place the clauses providing that the owner of the burdened land would not object to any application for a resource consent for a quarry.

Subsequent to the Court of Appeal hearing, Synlait had provided undertakings to NZIPL to the effect that it would not take any step in opposition to any application for resource consent for a quarry that NZIPL might make. These undertakings were substantially similar to the modifications sought in the notice of application. In light of the undertakings given, the Supreme Court considered the application as one for modification of the covenants.

No substantial injury

The first ground Synlait relied upon was s 317(1)(d), that modification of the covenants would not substantially injure NZIPL.

It is well established that for an injury to be substantial it must be "real, considerable, significant as against insignificant, unreal or trifling" (at [104] of the judgment). The Supreme Court reiterated that the injury may be economic (e.g. a reduction in the value of the benefited land), physical (e.g. subject to noise or traffic) or intangible (such as an impairment of a view, intrusion upon privacy, unsightliness or alteration to the character or ambience of the neighbourhood) (at [106]).

Assessment of substantial injury requires the Court to compare the position of the owner of the benefited land with the covenant in place to the position if the covenant is modified or extinguished. The evidence established:

1. There was real uncertainty about whether NZIPL would ever seek to establish a quarry on its land.
2. If NZIPL did make an application for a resource consent for a quarry, that application would not be easy with or without the presence of the Synlait plant due to changes that had occurred since creation of the covenants, namely:
   - the construction of a substantial infant formula manufacturing facility on land adjacent to Synlait's land;
   - the likely presence of another dairy factory and a milk product plant facility, planned for the area;
   - the substantial residential development.
3. While it could not be said that the presence of the Synlait plant on the burdened land would make no difference to the chances of an application for a resource consent succeeding, it was clear it would not make a substantial difference.

Unsurprisingly in the light of this evidence, the Supreme Court was satisfied that modification of the covenants would not substantially injure NZIPL and therefore the ground for the exercise of the court's discretion to modify the covenants in s 317(1)(d) was made out.

Changes in character of the neighbourhood

The Supreme Court also agreed with the High Court that the criterion in s 317(1)(a)(ii) was made out. Section 317(1)(a)(ii) allows the Court to extinguish or modify an easement or covenant because of a change in the character of the neighbourhood.

When the covenants were created in 1998 and 2000, Pokeno was rural in

character and had a population of 200 – 300 people. Since then, there had been many planning changes in the area which had led to significant commercial and residential development. At the time of the application in the High Court, Pokeno was a town of 3,000 with significant commercial development.

Prior to this decision, there had been some dispute in the authorities as to whether zoning changes were relevant to change in character of the neighbourhood. The Supreme Court found that zoning changes may be relevant under both s 317(1)(a)(ii) and s 317(1)(a)(iii). A zoning change in and of itself may not be decisive under s 317(1)(a)(ii). It would only be relevant if the zoning change led to a change in neighbourhood characteristics.

The 2008 Pokeno Structure Plan contemplated expansion and development of Pokeno. Plan Change 24, released in 2010 and operative in September 2012, paved the way for the expansion of Pokeno, rezoning the Synlait land and surrounding land from Rural to Industrial 2, with consequential industrial development occurring. The permitted uses of Synlait's land under the covenants (grazing, lifestyle farming and forestry) were no longer consistent with the zoning of the land and were now non-complying activities. The Supreme Court noted that the owner of the benefited land at the time, Winstone, had supported the planning changes.

Taking all these factors into account, the Supreme Court was satisfied that the changes in the neighbourhood were such that the covenants ought to be modified and that the grounds in s 317(1)(a)(ii) were also made out.

Impede reasonable use

The Supreme Court also found that the covenants now impeded reasonable use of the land to a greater extent. When the covenants were entered into, it was reasonable for the burdened land to be restricted to grazing or forestry operations. The reasonable use of the burdened land had changed because of the changes in zoning and the neighbourhood generally. In light of the current reasonable use of the land, the nature or extent of the impediment on the use of the land required by the covenants was now greater.

Contrary to the Court of Appeal, the Supreme Court was satisfied that the changes were not foreseeable when the covenants were entered into. The plan changes occurred in September 2012 and the evidence was that Pokeno was not identified for significant growth until 2007. The covenants had been created in 1998 and 2000.

Discretion

As the Supreme Court concluded that the grounds in s 317(1)(a)(ii), (b) and (d) were made out, it was required to consider whether it would have exercised its discretion to modify the covenants, in the absence of the settlement.

NZIPL argued that the fact that Stonehill and Synlait had acquired the land knowing it was subject to covenants and Synlait had constructed the plant in these circumstances ought to count against modification. The High Court accepted that Synlait had taken the risk as to the outcome of the appeal in continuing to construct the plant but it had acted lawfully at the time as the High Court had modified the covenants. The Supreme Court did not consider it appropriate to refuse modification to punish Synlait. It was relevant that Synlait had made out not one, but three, of the grounds in s 317.

Had there been no settlement, the Supreme Court would have allowed the appeal and made an order modifying the covenants.

Compensation

Under section 317(2) a court that makes an order extinguishing or modifying an easement or covenant may require compensation to be paid. The High Court had refused to grant compensation and the Supreme Court agreed. Its conclusion that no substantial harm had been done as a result of modification of the covenant meant that there was no basis for an award of compensation or that any compensation would be minimal.

NZIPL had also not filed any evidence in support of a claim for compensation despite having the opportunity to do so in the High Court. Settlement apart, the Supreme Court would have refused to remit the question of compensation back to the High Court and in the absence of any evidence as to an appropriate level of compensation, there was no basis for the Court to address the issue.

Costs

NZIPL would have also lost the orders for indemnity costs it received in the High Court and Court of Appeal in reliance on the clause of the covenant which held that the covenantor was to pay the covenantees' solicitors legal costs and disbursements in relation to enforcement of the deed.

The Supreme Court indicated that had the parties not settled, the Court would have awarded costs to Synlait in the Supreme Court and quashed the costs orders in the Courts below, replacing them with orders that no award of costs be made in the High Court and that costs in the Court of Appeal be reassessed. The Supreme Court held that although successfully opposing an order under s 317 could have amounted to enforcement, the clause did not apply to an unsuccessful opposition to an application for an order under s 317. ■

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