PROJECTS AND REAL ESTATE NEWS

AUGUST 2022

WELCOME

to Issue No. 15 of Projects and Real Estate News, Bell Gully's monthly digest on regulatory developments, together with cases and news of interest in the **projects** and **real estate** sectors.

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Need more information?
Projects and Real Estate News is a monthly digest on regulatory developments, together with cases and news of interest in the projects and real estate sectors.

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CASE NOTES

✱ REAL ESTATE

Court of Appeal considers the issue of redundant caveats

The Court of Appeal in *LSK Builders 2011 Limited v Chamberlain* [1] considered whether, once a mortgage is registered, a caveat previously lodged to protect the mortgagee's interest becomes redundant and thus may lapse on application to the court. The caveator in this case argued that sustaining the caveat was necessary because the priority amount inserted in the mortgage was insufficient to secure the debt that the caveator claimed was owing to them by the property owner.

Background

This case concerned a residential building contract (**Contract**) between Mr and Mrs Chamberlain (**Owners**) and a building company, LSK Builders 2011 Limited (**Builder**). The Owners had engaged the Builder to build their new home. The parties were in dispute about the payments due under the Contract.

The Contract gave the Builder a right to register a mortgage over the Owners' property, in order to secure the payment of monies due under the Contract. The Contract also included an acknowledgement that this right to register a mortgage contained in the Contract gave the Builder a right to lodge and maintain a caveat against the Owner's property.

The Builder lodged a caveat against the Owner's property to protect its right to register a mortgage. Subsequently, a mortgage was registered over the Owner's property with a priority amount of NZ$175,000 (the priority amount is the maximum amount that a mortgagee can receive from the proceeds of a mortgagee sale of the property, in priority over any other subsequent mortgagee).

The Owners then applied to the High Court to lapse (i.e. remove) the Builder's caveat. The Builder resisted the application. The Builder lost in the High Court, and appealed that decision.

The Court of Appeal decision

The Court of Appeal was asked to determine whether, once a mortgage is registered, a caveat previously lodged to protect the mortgagee's interest becomes redundant.

The Builder's lawyer argued that the caveat was necessary because the mortgage only provided the Builder with partial protection – in that the priority amount of NZ$175,000 in the mortgage was insufficient to cover accumulating interest and rising costs relating to the contractual debt. The Builder's lawyer explained that the NZ$175,000 amount was selected on the basis that this reflected the amount that the Builder considered was owing at the time that the mortgage was registered.

The Court of Appeal rejected this argument. It concluded that the contractual right to maintain a caveat is spent once the interest in land that the caveat protects (in this case the right to register a mortgage) is exercised, regardless of the consequences of including an insufficient mortgage priority amount. The court dismissed the Builder's appeal.

Key takeaways

A caveat can be a useful tool to protect a party's interest or claim in another party's land. However, this case highlights that a caveat will become redundant once the interest that the caveat sought to protect is registered. A party should therefore withdraw its caveat once the interest that the caveat sought to protect is registered.

This case also highlights that it is prudent for a mortgagee to nominate a realistic priority amount (that is sufficient to cover the amount owing as well as any potential additional accrued costs, such as interest) in a mortgage instrument (subject to any express terms in the relevant agreement).

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[1] [2022] NZCA 228

REGULATORY UPDATES

✱ REAL ESTATE

Ban on certain grocery covenants and lease provisions becomes law

Certain land covenants, lease provisions and other arrangements that restrict the development or operation of retail grocery stores are now unenforceable after the passing of the Commerce (Grocery Sector Covenants) Amendment Act 2022 (**Amendment Act**) into law at the end of June.

The Amendment Act was introduced to address concerns raised in the Commerce Commission's market study into the retail grocery sector. The study, released earlier this year, found that competition in the sector is not working well, and is detrimentally affecting consumer choices and grocery prices as a result.

The study made numerous recommendations to improve competition in the sector. One of them was to free up suitable land by, amongst other things, banning the practice by major grocery retailers to use land covenants and/or lease provisions to stop competitors from opening stores in proximate premises. We summarised the Commerce Commission's other land-related recommendations in Issue No. 11 of Projects and Real Estate News.

As the initial draft of the Amendment Act progressed through Parliament, the select committee suggested several changes to ensure it better captured the type of conduct that it was intended to prevent. Most of these suggestions have been incorporated in the final form of the Amendment Act.

The Amendment Act commenced on 30 June 2022, and provides for the following:

1. For the purposes of the Commerce Act 1986, the following are treated as prohibited and unenforceable if a 'designated grocery retailer' has an interest in them:
   a) a land covenant that has the purpose, effect or likely effect, of impeding the development or use of land as:
      i. a retail grocery store, or
      ii. any other retail store that is likely to compete with a retail grocery store operated by the 'designated grocery retailer'. This provision is intended to capture situations where a 'designated grocery retailer' defines their business more broadly than what one would typically associate with a supermarket (for example, defining their business as a store that sells fashion, bags, computer and appliances) to block such retail stores from operating;
      together, the **subject stores**;
   b) an exclusivity covenant (which is defined as including, without limitation, a right of first refusal) or other lease provision that has the purpose, effect or likely effect or impeding another person from operating any subject stores;
   c) provisions in any other contracts, arrangements, understandings, or covenants (**subject arrangements**) that has one or more of the same parties as the relevant lease or land covenant (as the case may be) and where, taken together, the subject arrangements and the relevant covenant or lease provision have the purpose, effect or likely effect of impeding another person from developing or operating any subject stores.
2. This prohibition applies irrespective of whether the covenant or lease was entered into before, on or after the Amendment Act was passed into law.
3. Covenants that have been authorised or given a clearance by the Commerce Commission, or a covenant reasonably necessary for environmental impact reasons relating to a retail fuel site under the Fuel Industry Act 2020, are excluded from the prohibition.
4. A 'designated grocery retailer' means Foodstuffs North Island Limited and Foodstuffs South Island Limited (who together own the 'Pak'n'Save' and 'New World' brands, alongside other retail grocery brands), and Woolworths New Zealand Limited (the owner of the 'Countdown' brand, alongside other retail grocery brands) and includes these entities' successors and franchisees.
5. The Governor-General can, subject to a specified process, designate another person or entity as a 'designated grocery retailer'.

6. A 'retail grocery store' means a place where a material part of the business is used to supply one or more categories of the following products to consumers: bread, dairy products, eggs or egg products, fruit, vegetables, meat, fish, rice, sugar, manufacturer-packaged food, and medicine (other than prescription medicine). This means that in addition to supermarkets, a butchery, bakery or pharmacy will also be considered a 'retail grocery store' under the Amendment Act.
7. A 'designated grocery retailer' is considered to have an interest in a covenant if, amongst other things, they:
   a) are or were a party to the covenant;
   b) are or were a party to any contract, arrangement or understanding that led to the giving of the covenant or its inclusion in a lease;
   c) required, or is deemed by the Commerce Act 1986 to have required, the giving of the covenant; or
   d) give effect to, carry out, or enforce the covenant.
8. Ordinarily, all the affected landowners must agree and sign certain documents to revoke or modify a land covenant registered on a property's title. The Amendment Act provides for a simplified process to encourage voluntary removal of the banned covenants. The 'designated grocery retailer' can, acting alone, sign the relevant documents if they wish to revoke or modify a land covenant that has been rendered unenforceable by the Amendment Act. This provision will be repealed on 30 June 2024.
9. To assess legal compliance with specified provisions in the Commerce Act 1986 and the Fair Trading Act 1986, the Commerce Commission can require a 'designated grocery retailer' to supply information relating to any subject arrangements (including any process relating to the negotiation of such subject arrangements) within a specified time and manner.

The New Zealand Herald has published other reports on this topic – Foodstuffs North Island axes 78 of 135 anti-competitive covenants after crackdown, and Countdown threatens to halve rent: How anti-competitive covenants worked.

The government has also announced that it will introduce a new industry watchdog – the Grocery Commissioner – and a mandatory Code of Conduct between the major grocery retailers and their suppliers, as the next stage of its response to the Commerce Commission market study.

Fair Trading Act changes commence mid-August affecting small trade contracts

Changes brought about by the Fair Trading Amendment Act 2021 will see the existing 'unfair contract terms' (**UCT**) regime extended to apply to standard form 'small trade contracts' from 16 August 2022. These are contracts where:

a) both parties are in trade,
b) the trading relationship has an expected annual value of NZ$250,000 (including GST, if any) or less when the relationship first arises; and
c) the contract meets the current criteria in the Fair Trading Act 1986 (**FTA**) as being in 'standard form' – i.e. the contract terms (other than terms as to price and the contract's subject matter) have not been subject to effective negotiation between the parties. For example, the contract may be presented on a 'take it or leave it' basis, which can be more common when there is an imbalance of bargaining power between the parties.

Contracts that the new UCT regime can potentially capture include commercial leases, where the initial rent is NZ$250,000 (including GST) or less. The new regime may apply where, for example, a large scale landlord offers bespoke leases to smaller retail tenants on a 'take it or leave it' basis. The new regime will be less likely to apply where there is typically room to negotiate before entering the lease.

A contract term can be declared 'unfair' only if the court is satisfied that the following three requirements are met:

a) the term would cause a **significant imbalance** in the parties' rights and obligations arising under the contract;
b) the term is **not reasonably necessary to protect the legitimate interests** of the party who would be advantaged by the term; and
c) the term would **cause detriment** (whether financial or otherwise) to a party if the term were applied, relied on or enforced.

Further discussion on these concepts is available in the Bell Gully update here and the Bell Gully Guide to Unfair Contract Terms in Business Contracts. Please click here to request a copy of the Guide.

If a term has been declared unfair by a court and a business uses or enforces the unfair term, it may be convicted and fined under the FTA, with a maximum fine for companies of up to NZ$600,000 per breach, or be ordered to pay damages, undertake corrective advertising or refund money.

PROJECTS

MBIE launches review of building consent system

The Ministry of Business, Innovation and Employment (**MBIE**) has launched a substantive review of the building consent system this month. The aim of the review is to modernise the system and provide assurance to building owners and users that building work will be done right the first time.

The issues discussion document released by the MBIE noted the review is needed now, with the building consent system under pressure to process a record number of consents, and the methods for building and design having changed significantly since the system was established in 1991.

The scope of the review is intended to encompass:

- **How the regulatory regime is structured** – this involves examining the role of the building consent authorities, trade practitioners, designers and other parties. The review will also look at the decision-making processes, including how code compliance is verified, and the level of discretion available to regulators.
- **How regulation is implemented** – this includes considering approaches to the regulation and management of risk in the system, capacity and capability of building consent authorities, and the extent that Māori perspectives are provided for.
- **How the regulatory system is managed** – this includes examining the extent to which the Building Act 2004 and associated regulations are up-to-date and agile, and the tools available to MBIE to intervene when things go wrong.

The rules for allocating liability in civil cases where building defects are found and damage is incurred by the building owner is not within the scope of this review. MBIE has published a policy position statement setting out the reasons for this, and why capping liability costs for building consent authorities and limiting these authorities' duty of care is not considered necessary or beneficial at this time.

However, as covered above, the review is intended to support the sector to get building work right the first time, while ensuring the system appropriately manages risks associated with building work.

As the first step in the review, MBIE is consulting on the issues discussion document. Public submissions are sought on whether the issues identified in the issues discussion document are the right ones, and whether the desirable outcomes outlined in the document are the right ones and if so, the extent to which the current system already delivers on these outcomes.

Submissions close on 4 September 2022. After that, MBIE will analyse the submissions, undertake further work to narrow down the key issues and develop options for a new or revised building consent system for public consultation in 2023.

For full details, please see the MBIE webpage here.

OTHER NEWS

PROJECTS

Regions to receive boost from government's Infrastructure Acceleration Fund

The Infrastructure Acceleration Fund (**IAF**) was launched by the government in June 2021. The IAF is a fund of approximately NZ$1 billion to support infrastructure projects that will enable more houses to be built, and is administered by Kāinga Ora.

Applications to the IAF have now closed. However, councils, iwi and developers were eligible to apply for IAF funding. Priority is given to support projects that will deliver the most houses in locations that experience infrastructure constraints and face the biggest housing supply and affordability issues.

Last month the government announced that a total of NZ$179 million has been approved to support infrastructure projects across seven regional centres. The seven regions first to receive IAF funding are Rotorua, Omokoroa, Kaikoura, Otaki, Napier, Gisborne and New Plymouth. The government said the funding is expected to support the development of over 8,000 new homes across these regions.

Key projects that will benefit from the funding announced this month include flood management and stormwater infrastructure in Rotorua, upgrade of a State Highway 2 intersection that will provide safer access and cater for anticipated growth for the town of Omokoroa in the Western Bay of Plenty, and a local link road and cycleway in Kaikoura. A joint application between the council, private developers and Māori landowners have also secured IAF funding to upgrade water supply and roading works in the Kapiti Coast town of Otaki.

A further 28 projects are currently undergoing due diligence and negotiations for IAF funding. Projects eligible for IAF funding include upgrading or building new infrastructure for drinking water, wastewater and stormwater, roading and transport, and flood management infrastructure, where such projects will enable the development of new homes. Costs eligible to be covered by the funding include early stage feasibility studies, design, consenting and in some cases land costs.

Read the government's press release here.

Bell Gully's projects and real estate team is across the current developments and trends in the industry. If you have an issue related to real estate or construction law that requires attention, we would be happy to assist.

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