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Topic: Revisiting encumbrances in light of the Law Commission proposal for statutory covenants in gross

1. Introduction

- 1.1 Subject to the debate discussed below, at common law and in equity the burden of covenants in gross cannot run with the servient land and therefore cannot bind the successors and assigns of the registered proprietor of the servient land.¹
- 1.2 This has led to the use of encumbrance instruments ("encumbrances") with the intention to secure such covenants against the servient land.
- 1.3 Encumbrances are provided for in section 101(4) of the Land Transfer Act 1952 and section 4 of the Property Law Act 2007 ("PLA"). An encumbrance is a mortgage.² They are used as a device to endeavour to secure collateral covenants over the servient land.
- 1.4 The Law Commission concluded in its Report ("LCR") that encumbrances should no longer be permitted to be used to secure collateral covenants in gross and proposed a new creature of a statutory covenant in gross.³ The LCR requires such covenants to "*touch and concern the land*" but is this equitable test correctly codified in the wording of the draft Land Transfer Bill ("Bill")?
- 1.5 In this opinion, I look at:
 - 1.5.1 Covenants in gross;
 - 1.5.2 The history of encumbrances;
 - 1.5.3 How encumbrances are used with some examples of encumbrances;
 - 1.5.4 The problems caused by encumbrances;
 - 1.5.5 Alternatives to encumbrances including caveats, statutory covenants, building schemes and other methods;
 - 1.5.6 When does the burden of a covenant run with the servient land?
 - 1.5.7 The test in equity;
 - 1.5.8 Property Law Act changes;
 - 1.5.9 What is meant by "*touch and concern the land*"?
 - 1.5.10 The Law Commission Proposal;
 - 1.5.11 The draft Bill;
 - 1.5.12 Is the proposed wording in the Bill too restrictive?

¹ *Staples & Co (Ltd) v Corby and the District Land Registrar* (1900) 19 NZLR 517.

² Section 4 of the PLA and 101(4) of the Land Transfer Act 1952

³ Law Commission Report, A New Land Transfer Act, Report 116, June 2010 at para 7.35 and 7.37

1.5.13 The consequences of encumbrances remaining.

- 1.6 For reasons which I will elaborate on further in this opinion, in my view, there is a need for a method of securing collateral covenants in gross against the servient land so as to bind future owners of the servient land. Due to their problems, I do not favour the continued use of encumbrances. The introduction of the proposed statutory covenants in gross (as suggested in the LCR, but not the draft Bill) would be a positive step. The ambit of the proposed statutory covenants should however be widened as the current use of encumbrances is not limited to those covenants which touch and concern the servient land.

2. Covenants in gross

- 2.1 A covenant in gross is a covenant which does not have dominant land.
- 2.2 Subject to the ordinary rules of contract, as between the original parties⁴, the land covenant will be binding due to privity of contract.⁵
- 2.3 A covenant in gross is personal in nature as it does not have any land to which its benefit attaches and therefore cannot meet the common law test that the benefit of the covenant run with the dominant land.
- 2.4 At common law, the burden of a covenant in gross does not run with the servient land.⁶
- 2.5 Later, in equity, the burden of a restrictive or negative covenant was permitted to run with the servient land⁷ and this was extended to positive covenants from 1 January 1987.⁸ Section 126 of the Property Law Act 1952 ("PLAR"⁹) (now section 307 of the PLA) was restricted to notation only of covenants against the title to the land (as opposed to registration) and still required there to be dominant land.¹⁰
- 2.6 There was debate as to whether covenants in gross were enforceable against successors in title of the servient land in New Zealand.¹¹
- 2.7 In *Staples* the Court of Appeal held that, on an application to bring land under the Land Transfer Act, the holder of the benefit of a restrictive covenant did not have a sufficient interest to lodge a caveat to prevent that application.¹² The Court of Appeal did however hold that dominant land was not required to create a valid covenant the burden of which runs with the servient land. Therefore covenants in gross were permitted.
- 2.8 The debate was not resolved by section 126 of the PLAR as one of its requirements for notation of a covenant was that there be a dominant land. From 1 January 1987

⁴ And, subject to certain rules which are not discussed here, their heirs.

⁵ Hinde Campbell & Twist, *Principles of Real Property Law*, LexisNexis, Wellington 2007 at para 17.004

⁶ Hinde Campbell & Twist, *Principles of Real Property Law*, LexisNexis, Wellington 2007 at para 17.004

⁷ *Tulk v Moxhay* (1848) 2 Ph 774, 41 ER 1143

⁸ Hinde Campbell & Twist, *Principles of Real Property Law*, LexisNexis, Wellington 2007 at 17.004, sections 64A and 126A PLA 1952

⁹ referring to the repealed Property Law Act 1952

¹⁰ *Bezett v Aspen Grove Limited* (2005) 6 NZCPR 753

¹¹ I D Campbell "Restrictive Covenants Affecting Land: Is a Dominant Tenement Necessary in New Zealand?" (1944) 20 NZLJ 68 and E M Brookfield "Restrictive Covenants In Gross" [1970] NZLJ 67.

¹² Above at n1.

section 64A of the PLAR required the covenant to be “*intended to benefit the owner for the time being of the covenantee’s land*”.

- 2.9 In *Anzco* the Court of Appeal declined to follow *Staples*.¹³ *Anzco* sets out the New Zealand position that a dominant land is required to create a valid covenant which runs with the servient land.¹⁴ This was confirmed in *Omaha Beach*.¹⁵
- 2.10 This position compares to easements in gross where the burden of the easement runs with the servient land and binds the grantor’s successors in title without the need for dominant land.¹⁶ Section 291(3) of the PLA provides that an easement in gross binds not only the covenantor and its successors in title but also “*any person claiming through the covenantor or the covenantor’s successor in title, including an occupier for the time being of the burdened land*”.^{17 18}
- 2.11 It has been argued that as easements in gross are permitted to be created by section 291 of the PLA¹⁹ then, as land covenants create equitable easements, by extension covenants in gross should be permitted.²⁰ This argument is also advanced by section 303 of the PLA²¹ when viewed in conjunction with section 306(b) of the PLA²².
- 2.12 Section 303(1) of the PLA allows the burden of both positive and restrictive covenants to run with the land if:
- “(a) *the covenant burdens the land of the covenantor and is intended to benefit the owner for the time being of the covenantee’s land; and*
- (b) *there is no privity of estate between the covenantor and the covenantee.*”
- 2.13 Section 306(b) of the PLA provides that section 303 of the PLA “*does not limit or affect ... the law relating to restrictive covenants in gross*”. One view of this section is that it impliedly recognises that restrictive covenants in gross are enforceable. However, that view would then suggest that positive covenants in gross are not enforceable.
- 2.14 An alternate view of section 306(b) of the PLA is that it is a statement that, whatever the law may be regarding restrictive covenants in gross, it is not affected by section 303 of the PLA. In *Land Law* it is suggested that this is the “*more tenable*” interpretation.²³
- 2.15 It is difficult to see how section 303 of the PLA would apply to covenants in gross given that it is a requirement of section 303(1)(a) of that Act that the covenant be “*intended to benefit the owner for the time being of the covenantee’s land*”. This intention can only be established where the covenant is intended to benefit the dominant land rather than the original covenantee.

¹³ *Anzco Foods Waitara Limited v Affco NZ Limited* [2006] 3 NZLR 351.

¹⁴ *Supra* at note 13

¹⁵ *Omaha Beach Residents Society Incorporated and GNS Trust Limited v Townsend Brooker Limited et al* [2010] NZRMA 53, (2009) 10 NZCPR 580, *Omaha Beach Residents’ Society (Inc) v Townsend Brooker Limited* [2010] NZCA 413

¹⁶ Section 122 PLAR and section 291 of the PLA.

¹⁷ Section 291(3)(c) of the PLA

¹⁸ The use of “*grantor*” rather than “*covenantor*” would have been more appropriate.

¹⁹ (and its predecessor section 122 of the PLAR)

²⁰ *Land Law*, Westlaw NZ, para 9.18.01(4)

²¹ (and its predecessor section 64A of the PLAR)

²² (and its predecessor section 64A (5) of the PLAR)

²³ *Land Law*, Westlaw NZ, para 9.18.01(4)

- 2.16 The alternate view of section 306(b) of the PLA is also supported by section 307 of the PLA allows notification of positive and restrictive covenants but only where they benefit other land.²⁴

3. History of encumbrances

- 3.1 Given the debate referred to above regarding whether covenants in gross were personal, alternatives were sought. In 1938 Adams suggested that to secure such a covenant there be a rent charge of £20 reduced to a peppercorn if the provisions of the covenant were complied with.²⁵ This was following the prevalence of rent charges in England which have a completely different background.
- 3.2 In the United Kingdom rent charges have a long history arising from the statute *Quia Emptores* in 1290. The New Zealand LCR noted that by 1975 there were at least four different uses of rent charges in England.²⁶ In *Jackson Mews*, the Court of Appeal reviewed the history of rent charges.²⁷ It noted that the third category of rent charges “*forming an integral part of schemes beneficial, directly or indirectly, to the land charged*” were considered sufficiently beneficial by the UK Law Commission that it recommended that they were permitted to continue in existence notwithstanding the ban on other rent charges.²⁸ Such class of rent charges are building schemes which are discussed in more detail below. The recommendations of the UK Law Commission were largely incorporated into the Rentcharges Act 1977 (UK).
- 3.3 In 1970 in New Zealand Brookfield suggested the use of a deed of covenant containing a covenant in gross in favour of the covenantee together with an encumbrance securing a rent charge which was not payable so long as the covenants in the deed were complied with.²⁹ These suggestions evolved into the modern use of encumbrances (as more particularly described below).

4. How encumbrances are used with some examples

- 4.1 As set out above, encumbrances are a device to secure land covenants in gross. They charge the land with a rent charge (which is usually a nominal amount) to endeavour to secure land covenants as collateral covenants against the servient land. Adams noted that the encumbrance “*may also be employed when its principal purpose is, not the securing of an annuity, rent-charge, or sum of money, but the performance of a restrictive covenant or personal covenant, the securing of the sum of money in the prescribed form being merely the means by which that principal purpose is achieved*”.³⁰
- 4.2 Thomas has drawn a distinction between collateral covenants and ancillary covenants.³¹ He defined collateral covenants as “*covenants the benefit of which are intended to be either personal to the encumbrancee, or are not relevant to securing the property to provide for the rent charge or annuity*”. Ancillary covenants were defined as “*covenants which support the purpose of the encumbrance*”.

²⁴ Section 307(1) (c) of the PLA

²⁵ E C Adams “Restrictive Covenants” (1938) 14 NZLJ 320 at 322

²⁶ LCR at para 7.22

²⁷ *Jackson Mews Management Limited v Menere* [2009] NZCA 563 starting at para 22

²⁸ *Jackson Mews* at para 28 quoting para 48 of the UK Law Commission Report Law Com 68

²⁹ E M Brookfield “Restrictive Covenants in Gross” [1970] NZLJ 67

³⁰ E C Adams “Memorandum of Incumbrance” [1950] NZLJ 171 at 172 (see note in bibliography re spelling)

³¹ R Thomas “Possible Hazards of Memoranda of Encumbrance” (1997) 8 BCB 1

Ancillary covenants are the machinery parts of the encumbrance itself whereas collateral covenants are not related to the encumbrance itself.

- 4.3 The rent charge is not payable so long as the covenants contained in the encumbrance have been complied with.
- 4.4 There is no dominant land to which the benefit of the encumbrance attaches and they are intended to be for the benefit of covenantee who does not own land which will benefit from the covenants contained in the encumbrance. They are intended to bind the covenantor and the successors in title of the covenantor.
- 4.5 In the encumbrance it is usual to contract out of the powers implied in mortgages by the PLA. Such excluded powers include the power of sale, the right to enter possession and the right to collect the rents from the land.³² Particularly where the rent charge is a nominal amount, this will render the rent charge “*virtually valueless in itself*” but as noted by Brookfield the intended remedy (although its effectiveness is debatable as discussed below) is enforcement of the covenants themselves.³³
- 4.6 Examples of encumbrances are set out in the LCR ³⁴ and Property Law Section (“PLS”) submission³⁵. These include:
 - 4.6.1 *In a subdivision to require owners of the lots to join a residents’ association and pay annual fees.*
 - 4.6.2 *In a subdivision to require owners to enter contracts with a utility provider and pay charges for the use of the facilities.*
 - 4.6.3 *To provide that a boatshed be placed on one lot in the subdivision, the owners in the subdivision being shareholders in the jetty.*
 - 4.6.4 *To set out restraint of trade provisions in relation to a piece of land.*
- 4.7 In schedule B of its submission the PLS gave examples of the use of encumbrances (some of which are cited in the LCR) as:
 - 4.7.1 *By councils to enforce a variety of covenants.*
 - 4.7.2 *In subdivisions to require owners of the lots to join a residents’ association and to pay annual levies.*
 - 4.7.3 *In unit titled apartments requiring owners to join an owners’ association.*
 - 4.7.4 *In subdivisions to require owners to enter into standard contracts with a utility provider and to pay charges for the use of utilities.*
 - 4.7.5 *To require owners to enter into franchise or supply agreement.*
 - 4.7.6 *To set out restraint of trade provisions.*

³² T Gibbons and K O'Donnell, New Zealand Law Society Seminar, Easements and Covenants – pushing the boundaries July 2008 at page 10

³³ E M Brookfield “Restrictive Covenants In Gross” [1970] NZLJ 67 at 70

³⁴ LCR at para 7.8 n177 LCR.

³⁵ New Zealand Law Society Property Law Section, “Submission on *Review of the Land Transfer Act*” (11 May 2009)

- 4.7.7 *In place of carparking/ signage easements or to secure compliance under a carparking/signage licence.*
 - 4.7.8 *To prohibit an owner from objecting to the presence of an electricity company's infrastructure on their land.*
 - 4.7.9 *To provide that a boatshed would be placed on one lot in a subdivision (the owners in the development were shareholders in the jetty company).*
 - 4.7.10 *To secure performance of an owner's obligations under an agreement in relation to fire separation.*
 - 4.7.11 *To secure compliance with a right of first refusal to offer a property back to a third party.*
 - 4.7.12 *Otherwise, in place of covenants in gross to record on the title all manner of contractual obligations.*
 - 4.7.13 *A variety of miscellaneous uses, e.g. to require owners of properties with rights of way over an access strip to consent to and facilitate the access strip being vested as a road when desired.*
- 4.8 The PLS has referred to “*restraint of trade*” provisions as an example of an encumbrance. However, such provisions are usually personal in nature and included in an employment agreement or provided by the directors, shareholders or major employees of the business on its sale. It is more likely that the PLS was referring to restrictions on use of the land by competitors. It is not uncommon for major retail or fast food tenants (such as McDonalds or Bunnings) to seek a restriction on the leasing of other land within the development to its competitors and to have this restriction secured by an encumbrance.
- 4.9 Although Councils have the ability to note conditions of consent against the title to the land by way of a consent notice, it is still common practice for encumbrances to be used. I have commented below on the possible reason for this. The PLS has noted the use of encumbrances in instances where consent notices would be expected such as for fire waivers (for example recording that the units or accessory units have not been fire proofed in accordance with the fire rating requirements in the Building Code). Other examples are where there are other conditions such as a requirement for a geotechnical or engineering report prior to building consent being applied for or a private stormwater disposal system.
- 4.10 Encumbrances have also been used where there is a requirement for the owners of lots within the development to hold shares in a utilities company.³⁶
- 4.11 *ABCDE Investments Limited v Van Gog* concerned the validity of an encumbrance entitling a building manager to exercise a letting service in relation to a 23 unit residential complex.³⁷ It was argued that the encumbrance was invalid and unenforceable as it did not contain “*all of the essential terms necessary to give rise to an enforceable contract*”. It was held that “*... there is no need to embark upon a separate inquiry into whether the encumbrance is enforceable by virtue of the absence of essential terms. The prohibitory effect of the encumbrance is enforceable on its own.*”³⁸

³⁶ This also raises Securities Act issues.

³⁷ *ABCDE Investments Limited v Van Gog* [2013] NZCA 351

³⁸ *Supra* at note 37 at para 27

- 4.12 In *Omaha Beach Residents' Society (Inc) v Townsend Brooker Limited* the residents' society sought a declaration that a restrictive covenant was invalid.³⁹ The covenant was that no objections would be made to applications for resource consents or plan changes. The society wished to provide funding for objections to the Proposed District Plan to be made by members of the society whose land was subject to the covenant. The Court considered that this was not an appropriate case for it to issue the declaration sought. It was argued that the covenant was a covenant in gross (and therefore would not bind the members' land). It was noted that Lang J in the High Court had held that it was "*well arguable that the covenant was not a covenant in gross*".⁴⁰ Such a covenant may have been better secured by way of an encumbrance rather than a restrictive land covenant.

5. The problems caused by encumbrances

- 5.1 There are a number of problems associated with the current use of encumbrances.

5.2 Requirement for consent

- 5.2.1 As noted above, an encumbrance is a mortgage for the purposes of both the LTA and PLA.⁴¹ This means that the consent of the encumbrancee is required in all of the instances where mortgagee consent would be required.⁴² The relevant legislation has been summarised by LINZ and includes the grant, surrender or variation of a lease, easement, profit à prendre or other estates or interests in the land as well as many other dealings with the land (all of which could affect the mortgagee's interest in the land).⁴³
- 5.2.2 It is common for the wording of the encumbrance to expressly provide that the consent of the encumbrancee is not required to any dealings with the land not having priority to the encumbrance. The District Land Registrar ("DLR") at Land Information New Zealand ("LINZ") initially considered that LINZ had no discretion to dispense with the requirement for encumbrancee consent despite such wording. However in 2012 the DLR issued a practice note that a conveyancing practitioner can certify that the practitioner is holding the consent of the encumbrancee where there is such a provision in the encumbrance.⁴⁴
- 5.2.3 It seems somewhat artificial for the conveyancing practitioner to be asked to certify that they hold a consent when the encumbrance provides that consent is not required. It would be preferable for LINZ to amend the raft of certifications to expressly provide for this (ie. that the certification be amended so that the conveyancing practitioner certifies that the encumbrance provides that consent is not required).
- 5.2.4 This is also an issue for mortgagees. In its submissions supporting the introduction of statutory covenants in gross and the discontinuance of the use of encumbrances, the New Zealand Bankers' Association set out that it did not consider that mortgagees should be required to obtain the consent of encumbrancees to register a variation of a subsequent mortgage to increase the priority sum in that mortgage (as they currently have to do) and

³⁹ *Omaha Beach Residents' Society (Inc) v Townsend Brooker Limited* [2010] NZCA 413

⁴⁰ Supra at note 15 at para 41

⁴¹ Section 101(4) of the Land Transfer Act 1952 and section 4 of the PLA

⁴² Section 102(4) of the Land Transfer Act 1952

⁴³ Land Information New Zealand, Landwrap, February 2011

⁴⁴ Land Information New Zealand, Landwrap, May 2012

supported the proposal to “*treat covenants in gross in the same way as restrictive and positive covenants*”.⁴⁵

5.3 Funding

- 5.3.1 Ordinarily, a mortgage advance to fund the purchase of a property will be a first and exclusive charge over the property. Where there is an encumbrance, it is usual for the encumbrance to be a first charge. Therefore the mortgage advance will be a second mortgage (rather than a first mortgage). Adams commented that if the rent charge is more than a nominal amount, it may cause problems with funding.⁴⁶
- 5.3.2 Conversely, where the encumbrance is not a first charge, this can cause problems for the validity of the encumbrance as prior chargeholders will be able to sell the land free of the encumbrance in the event of a mortgagee sale.

5.4 Possible redemption

- 5.4.1 The arguments for and against the use of encumbrances were debated by Brookfield⁴⁷ and Thomas⁴⁸. Brookfield advocated their use and Thomas cautioned about the hazards of their use. Thomas referred to the decision in *Schnauer* (see below) and the statutory right of redemption under section 151 of the PLAR.
- 5.4.2 The hazards included whether an encumbrances could be discharged upon payment of the rent charge payable during its term. This issue was considered in *Schnauer*, *Davison* and *Jackson Mews*.⁴⁹ In these cases, the Courts have been concerned that an encumbrance is a possible clog on the equity of redemption.
- 5.4.3 *Schnauer* concerned an application to sustain a caveat claiming an interest arising from an agreement to mortgage between the registered proprietor as mortgagor and the council as mortgagee. The mortgage secured the sum of 10 cents. The proprietor tendered the sum of 10 cents and contained an indemnity in favour of the Council in relation to erosion. The Court ordered that the caveat lapse. The Court considered that the Council needed to show not only that “*the indemnity was a collateral advantage which would survive the redemption of the mortgage, but somehow or other remain as a caveatable interest*”. The Court cited *Hinde McMorland & Sim* where a “*collateral advantage*” was described as:

“*A stipulation which, being a term of a mortgage, secures to the mortgagee some advantage in addition to repayment of the loan with interest.*”⁵⁰

⁴⁵ New Zealand Bankers' Association, Submission to Land Information New Zealand on the Recommendations contained in the Law Commission Report 116 “A New Land Transfer Act”, 5 October 2010

⁴⁶ Above at n 25

⁴⁷ E M Brookfield “Possible Hazards of Memoranda of Encumbrance – a Reply” (1998) 8 BCB 13

⁴⁸ R Thomas “Possible Hazards of Memoranda of Encumbrance” (1997) 8 BCB 1

⁴⁹ *The Thames - Coromandel District Council v Schnauer HC, Hamilton (M 247A/93) 18 March 1994*, Master Towle noted (1994) 6 BCB 271, *Davison Properties Limited v Manukau City Council* (1979) 7 NZTPA 42, *Jackson Mews Management Limited v Menere* [2009] NZCA 563

⁵⁰ *Hinde McMorland & Sim Land Law Vol 2 para 8.055 at page 786*

5.4.4 In *Schnauer* the Court considered the House of Lord's decision in *Kreglinger v New Patagonia Meat & Cold Storage Co Limited*⁵¹ and concluded that there was no rule in equity that there cannot be a collateral advantage in a mortgage which is to survive the redemption of the mortgage "*provided that such collateral advantage is not either:*

- (a) *Unfair or unconscionable, or*
- (b) *In the nature of a penalty clogging the equity of redemption, or*
- (c) *Inconsistent with or repugnant to the contractual or equitable right to redeem."* [formatting added]⁵²

5.4.5 *Davison* concerned an appeal against a condition of a subdivision consent requiring an encumbrance to be registered against the title to the land to draw purchasers' attention to a foundation investigation report. The condition was cancelled. Although the Planning Tribunal did note that the land owner had offered to enter into a deed with Council to this effect and the Tribunal trusted that it would do so. The Tribunal referred to the proposed encumbrance as a "*device*" and noted that "*Registration of it would cause certain conveyancing complications, and would create a blot on the title*".

5.4.6 **Menere v Jackson Mews**

- (a) These decisions differ from the more recent decision in *Menere v Jackson Mews*.⁵³
- (b) This case concerned an encumbrance registered over units in a retirement village purporting to secure a covenant that the residents enter into a management services agreement. The applicant sought a discharge of the encumbrance by tendering the full amount of the rent charge. Tender was not accepted.
- (c) Initially the High Court had ordered the discharge of the encumbrance.⁵⁴ As noted in the Court of Appeal judgment⁵⁵ that decision caused concern in "*conveyancing circles*" and it was hoped that it would be reversed⁵⁶ as it effectively rendered encumbrances useless as a device to register covenants in gross.
- (d) In the Court of Appeal Baragwanath J referred to the common law rules stated in *Kreglinger* referred to above, as confirmed by section 81(2) of the PLAR and section 97(2) of the PLA, but restricted the application of these rules to "*land intended as a security for a loan*".⁵⁷
- (e) The Supreme Court refused leave to appeal and stated:

"To conclude that the applicant is entitled to a discharge would also defy commonsense; the obvious purpose of the obligation to pay a

⁵¹ *Kreglinger v New Patagonia Meat & Cold Storage Co Limited* [1914] AC 25

⁵² Supra at note 48 at page 9

⁵³ Also at para 5

⁵⁴ *Menere v Jackson Mews* (2008) 9 NZCPR 898

⁵⁵ *Jackson Mews Management Limited v Menere* [2009] NZCA 563

⁵⁶ M Goodger "Instruments of Encumbrance and Restrictive Covenants in Gross" 4 September 2009 www.international.lawoffice.com/newsletters

⁵⁷ At para 61

nominal amount (if demanded) is to secure performance of the management services agreement, which could not be brought to an end unilaterally if there were no breach by the respondent".⁵⁸

- (f) The Supreme Court also noted the wording of section 97(2) of the PLA which requires the mortgagee to discharge the property from the mortgage upon "*payment of all amounts and the performance of all other obligations secured by the mortgage*". The Court emphasised the second part of the requirements of this section: being the performance of all other obligations.

5.4.7 Therefore there is the risk of an encumbrance being discharged.

5.5 Other problems

5.5.1 The LCR comments that, although they run with the land, land covenants in equity are not indefeasible.⁵⁹

5.5.2 The LCR also comments on the inelegance and artificiality of the device of the encumbrance.⁶⁰

6. Alternatives to encumbrances

6.1 There are a number of alternatives to encumbrances such as caveats, statutory covenants and land covenants in the nature of a building scheme.

6.2 Caveats

6.2.1 The Law Commission Issues paper commented on the use of caveats to protect unregistered interests.⁶¹ It was noted that caveats are only "*designed to give temporary protection*" and that there was evidence of their infrequent use to protect interests during the period before the interest is registered.

6.2.2 It is difficult to see how a caveat could be an effective solution as it would cause as many, if not more, conveyancing problems than encumbrances and would require an interest in land to support a caveatable interest (which the Court did not find in *Schnauer*⁶²).

6.3 Statutory Covenants

6.3.1 There are a number of covenants in gross created by statute (usually in favour of either the Crown or the local territorial authority). These include:

- (a) Conservation covenants preserving heritage areas as well as the natural environment⁶³; and

⁵⁸ At para 5

⁵⁹ LCR at para 7.14

⁶⁰ LCR at para 7.10 and 7.28.

⁶¹ LC Issues Paper at para 6.36

⁶² *The Thames - Coromandel District Council v Schnauer* HC, Hamilton (M 247A/93) 18 March 1994, Master Towle noted (1994) 6 BCB 271

⁶³ Section 22 of the Queen Elizabeth the Second National Trust Act 1977, section 27 Reserves Act 1977 and section 27 of the Conservation Act 1987, sections 6 – 8 of the Historic Places Act 1993

- (b) Conditions of resource consents (whether the consent is for land use or subdivision)⁶⁴.

6.3.2 Consent notices, which are a method of notifying the conditions of the resource consent on the certificate of title to the property, were legislated to overcome the need for encumbrances.⁶⁵ Thomas has commented previously that Councils may wish to continue to use encumbrances rather than consent notices so there is no argument that the covenants are ultra vires the consent procedure.⁶⁶ In their seminar paper Gibbons and O'Donnell listed the following examples of consent notices:

- “(a) *Requirement to engage a professional to design a stormwater disposal system prior to the erection of any dwelling on the site;*
- (b) *Monitoring of potable water supply to be in compliance with council standards;*
- (c) *Domestic and firefighting water storage installation prior to the erection of a dwelling;*
- (d) *Compliance with approved landscape plans and/or maintenance of vegetation;*
- (e) *Fencing; and*
- (f) *Roof materials and cladding restrictions.”*⁶⁷

6.3.3 This use of land covenants, as opposed to consent notices, was considered in *Barker v Queenstown Lakes District Council*.⁶⁸ Here a consent notice had been registered which was not within the ambit of the consent condition. The Court declined to set aside the consent notice as the consent notice had been relied upon by the neighbouring owners when purchasing their properties. In anticipating the need to distinguish a similar decision to be issued at the same time⁶⁹ Fogarty J noted that the “*Court of Appeal reasoning relies significantly upon the integration within the Resource Management Act of the indefeasibility regime for registered interests under the Land Transfer Act*”.⁷⁰

6.4 Building schemes

6.4.1 Building schemes are common for new subdivisions to preserve the character and standards of the development. They usually regulate the construction materials that can be used, minimum size of dwelling, uses on the land and the like.

6.4.2 It is common for building schemes to be registered using a common easement instrument which is registered over the entire development by the original developer prior to the sale of the individual lots.

⁶⁴ Sections 109, 221 and 240 of the Resource Management Act 1991.

⁶⁵ Section 221 of the Resource Management Act 1991

⁶⁶ R Thomas “Encumbrance Instruments” [2010] NZLJ 10

⁶⁷ T Gibbons and K O'Donnell, Easements and Covenants – pushing the boundaries, NZLS seminar July 2008 at para 8

⁶⁸ *Barker v Queenstown Lakes District Council* (2006) 7 NZCPR 216

⁶⁹ *Rodney District Council v Fisherton Limited* (2005) 12 ELRNZ 38, [2005] NZRMA 514

⁷⁰ Supra at note 68 at para 4

6.5 Other methods

6.5.1 Hinde McMorland & Sim lists at least six other methods for securing covenants⁷¹ being:

- (a) **A chain of indemnity covenants** - here there are a series of deeds (or a chain) between each vendor and purchaser so that there is not a direct covenant between the covenantee and each successive owner but indemnities between the successive owners. The UK LCR noted that this has a number of short comings – particularly as the only remedy is damages as opposed to an injunction or specific performance.⁷² It is also possible that the chain will be broken by for example the insolvency of one of the parties.
- (b) **A mutual deed of covenants** - whereby a series of direct deeds are entered into between the registered proprietor from time to time of the land and the covenantee. A proprietor will covenant not to sell or dispose of the property without obtaining a like covenant from the transferee or disposee. The UK LCR noted that the chain can be broken where the transferor does not comply with this covenant and sells the property without doing so.⁷³ This method is commonly used for powers of attorney where there is a staged unit development, redevelopment rights or a staged cross lease.

The problems in relation to cross leases were canvassed in *Taylor Trading* where it was held that the covenant to execute the documents required to create the new cross lease was enforceable against the successor of the co-lessor without the need for a deed of covenant.⁷⁴
- (c) **The doctrine of *Halsall v Brizell***⁷⁵ - this doctrine (also known as the “benefit and burden principle”) provides that where there is a benefit and there is a cost associated with the benefit, a person cannot take the benefit without also agreeing to the costs or obligations associated with that benefit.
- (d) **Where the covenant is part of the “essential fabric” of the easement or profit à prendre** - it has been suggested that the burden of a positive covenant may run with the land where it is an “essential” or “integral” part of the easement or profit à prendre”.⁷⁶
- (e) **Alienation under a long term lease** – leases can be used to secure land covenants. One example where this technique has been used was to record a light well between two buildings. Care needs to be taken given the definition of a subdivision in section 218 of the Resource Management Act 1991 being a lease of part of a building for more than 35 years. The UK LCR referred to Megarry and Wade⁷⁷

⁷¹ Hinde, McMorland & Sim, Land Law , LexisNexis, para 17.042

⁷² UK LCR at para 7.48 page 137

⁷³ UK LCR at para 7.49 page 137

⁷⁴ *Taylor Trading Co Limited v Aitken*, High Court, Auckland, 16 December 1991 (CP 1798) Master Towle

⁷⁵ *Halsall v Brizell* [1957] Ch 169

⁷⁶ Hinde McMorland & Sim at para 17.042, *Cameron v Dalgety* [1920] NZLR 155; *Frater v Finlay* (1968) 91 WN (NSW) 730; *Rufa Pty Ltd v Cross* [1981] Qd R 365 (FC), noted (1982) 56 ALJ 45 (Aughterson), (1982) 56 ALJ 191 (Butt).

⁷⁷ Megarry and Wade, The Law of Real Property (6th ed 2000) para 16-023

noting that “*this method of circumvention has been described as an “artificial device, of untested validity and subject to difficulties”*”.⁷⁸

- (f) **Right of entry** – this involves the right of entry on the transfer of land which is exercisable upon breach of the covenants. The UK LCR refers to their use in rent charges.

6.5.2 In his discussion of *Taylor Trading*, Thomas noted that the Court had raised the prospect of covenants being enforceable under the Contracts (Privity) Act 1982. However, as noted by Thomas, that Act does not enable enforcement of covenants against non-contracting parties.⁷⁹

7. When does the burden of a covenant run with the servient land?

- 7.1 At common law the burden of a covenant cannot run with the servient land.⁸⁰
- 7.2 In equity the development of restrictive covenants allowed the burden of a covenant to run with the servient land if it “*touched and concerned the land*”.
- 7.3 Since 1 January 1987 the burden of restrictive covenants have also been permitted to run with the servient land.⁸¹
- 7.4 These principles did not however allow the burden of covenants in gross to run with the land.⁸²
- 7.5 These principles apply regardless of whether a purchaser has notice of a covenant as they will only be bound by equitable interests and a “*mere contractual obligation*” is not an equitable interest in the land.⁸³

8. Test in Equity

- 8.1 McMorland sets out the essential requirements for the burden of a covenant to run with the servient land in equity being:
- “ (a) *The covenant must be negative in nature; and*
- (b) The covenant must benefit the dominant land; and*
- (c) There must have been a common intention that the burden should run with the covenantor’s land.*”⁸⁴
- 8.2 In order to benefit the land, the covenant must affect “*either the value of the land or the method of its occupation or enjoyment*”.⁸⁵

9. Property Law Act Changes

- 9.1 Section 64A (1) of the PLAR (now section 303(1) (a) of the PLA) allowed the notation of positive and negative covenants on the certificate of title of the servient

⁷⁸ UK LCR para 7.55 on page 139

⁷⁹ Thomas “Cross Leases and Future Development Covenants” (1992) 10 BCB 113 at 115 discussing *Taylor Trading* (supra at note 69)

⁸⁰ *Austerberry v Oldham Corporation* (1885) 29 Ch D 750 at 781 - 782

⁸¹ Section 64A of the PLAR

⁸² Hinde McMorland & Sim at paras 17.008 and 17.009

⁸³ McMorland, Easements, Covenants and Licences, para 13.1.3

⁸⁴ McMorland, Easements, Covenants and Licences, para 13.1.5

⁸⁵ *Re Gadd’s Land Transfer* [1966] Ch 56 at 66, [1965] 2 All ER 800 at 807 – 808 per Buckley J

land where the covenant “*is intended to benefit the owner for the time being of the covenantee’s land*”.

10. **What is meant by “*touch and concern the land*”?**

- 10.1 The requirement for a covenant to “*touch and concern the land*” originates from the law regarding covenants in leases.⁸⁶
- 10.2 Hinde describes the test to be used in leases as affecting “*the landlord in the landlord’s normal capacity as landlord or the tenant in the tenant’s normal capacity as tenant*”.⁸⁷ This applies where there is privity of estate but not of contract (for example where there has been a sale of the property or an assignment of the lease).
- 10.3 McMorland gives the example of the difference between a personal covenant of guarantee which is not enforceable under the rules of privity of estate by a subsequent landlord as opposed to a covenant by a surety that the tenant will perform a lease provision which touches and concerns the land which is enforceable by the subsequent landlord.⁸⁸
- 10.4 As the UK Law Commission put it, the covenant imposes a personal obligation or another obligation which “*might happen to take his fancy (for example, an obligation to buy petrol from a garage every month, or to pay an annuity to write a song)*”.⁸⁹
- 10.5 The recognition of building schemes by equity predates the doctrine of restrictive covenants.⁹⁰ “*This is done on the basis that there is a common intention to create, and a common interest to enforce, a scheme of reciprocal rights and obligations*”.⁹¹ It is an essential element that there be a common intention that all of the lots be bound at the time that the covenants are created.⁹²
- 10.6 In *Sawyer v Starr*⁹³ the Court noted that in *Elliston v Reacher*⁹⁴ Parker J had “*listed four criteria to be applied to test the existence of the necessary common intention. These, with only minor modifications, are still regarded as providing an appropriate initial test. They are restated in Hinde, McMorland and Sim, at para 11.024, p 1153, as follows:*
- (1) *Both the plaintiff and the defendant in the action for breach of covenant must ultimately have derived their title from a common vendor;*
 - (2) *Before sale of the land the common vendor must have laid out the land for sale in lots subject to restrictions intended to be imposed on all the lots, and which, though varying in detail as to particular lots, are consistent, and consistent only, with a general scheme of development;*
 - (3) *The restrictions must have been intended by the common vendor to be for the benefit of all the lots to be sold; this intention may be gathered from all the circumstances of the case, including in particular the nature of the restrictions,*

⁸⁶ McMorland, Easements, Covenants and Licences, para 12.1.3

⁸⁷ Hinde Campbell and Twist para 17.002

⁸⁸ McMorland, Easements, Covenants and Licences, para 12.1.3

⁸⁹ UK Law Commission Report, *Easements, Covenants and Profits à Prendre: A Consultation Paper* (CP 186, London 2008) at para 8.75

⁹⁰ Hinde McMorland and Sim at para 17.018 and 17.025

⁹¹ Hinde McMorland and Sim at para 17.018 and 17.025

⁹² McMorland, Easements, Covenants and Licences, para 13.2.6

⁹³ *Sawyer v Starr* [1985] 2 NZLR 540

⁹⁴ *Elliston v Reacher* [1908] 2 Ch 374

and if observance of the restrictions is in fact calculated to enhance the value of the land the requisite intention may be easily inferred;

- (4) *The purchaser from the common vendor bought on the footing that the restrictions on the lots purchased were to be for the benefit of the other lots in the scheme; if the first three points are established, this fourth point may be readily inferred provided the purchasers have notice of the factors involved in the first three."*

- 10.7 Both common law and equity require a covenant to "*touch and concern*" the land in order for the covenant to bind the successors in title of the covenantee.
- 10.8 In *Rogers v Hosegood*⁹⁵ Farwell J adopted the definition of "*touch and concern the land*" given by Bayley J in *Congleton Corporation v Pattison*⁹⁶ being that "*the covenant must either affect the land as regards mode of occupation, or it must be such as per se, and not merely from collateral circumstances, affects the value of the land.*"
- 10.9 McMorland notes that "*At common law the requirement was not elaborated further than this but that it was taken up by equity in regard to restrictive covenants and has been the subject of further development in those cases*".⁹⁷
- 10.10 In *Omaha Beach* the High Court explored whether the covenant was a restrictive covenant.⁹⁸ They cited the description of a restrictive covenant from Hinde McMorland and Sim being:

*"...a promise or agreement made by the owner of the servient land with the owner of the dominant land that the covenantor **will not do some act in relation to the servient land which he or she could otherwise do.** If the promise is negative in substance and benefits the dominant land, it will run with the servient land in equity, thus constituting an equitable interest in that land which binds the covenantor's successors in title who take with notice of it. (emphasis added)"*⁹⁹

- 10.11 In *Omaha Beach* the Court noted that it could be argued that the covenant not to object to applications for resource consent by the owner of the dominant land was not restricting the use of the servient land and did not prevent them from carrying out any activity on their land.¹⁰⁰

11. Outline of the Law Commission Proposal

- 11.1 The Law Commission issues paper only made a brief reference to the use of encumbrances as a mechanism to secure collateral covenants.¹⁰¹ Submissions were made by the Property Law Section¹⁰², following receipt and consideration of which a more extensive proposal was set out in the LCR and the draft Bill.¹⁰³ Further submissions were made by the Property Law Section on the draft bill (including in relation to encumbrances).¹⁰⁴

⁹⁵ *Rogers v Hosegood* [1900] 2 Ch 388

⁹⁶ *Congleton Corporation v Pattison* (1808) 10 ease 130 at 135

⁹⁷ McMorland, Easements, Covenants and Licences, para 12.1.3

⁹⁸ Supra at note 15

⁹⁹ Supra at note 15 at para 44

¹⁰⁰ Supra at note 15 at para 45

¹⁰¹ Issues Paper at para 6.33

¹⁰² New Zealand Law Society Property Law Section "Submission on *Review of the Land Transfer Act*" (11 May 2009)

¹⁰³ LCR at chapter 7

¹⁰⁴ New Zealand Law Society Property Law Section "Land Transfer Act Review – Government Response" (11 October 2010)

- 11.2 The LCR outlines in its report the history of encumbrances and their application. Instead of encumbrances, the LCR has proposed a statutory covenant in gross to “ensure their validity and make their creation transparent”.¹⁰⁵
- 11.3 The LCR sets out the limits of the new statutory covenants in gross which include that the covenant must “touch and concern the land”.¹⁰⁶ The LCR notes that this test is not “immediately applicable as there is no “dominant tenement (benefited land) which the covenant must “touch and concern””.¹⁰⁷ There needs to be some connection between the covenant and the use of the servient land.
- 11.4 The LCR gives the examples of:
- 11.4.1 “A covenant in favour of a territorial authority that the land must not be used for a commercial purpose”; and
- 11.4.2 “A covenant that benefits a residents’ association that requires certain maintenance activities to be performed on the land.”¹⁰⁸
- 11.5 It is interesting that in equity there was a requirement for a dominant land as there were no covenants in gross. The requirement for the covenant to “touch and concern” the land was therefore frequently described as a requirement that the covenant benefit the dominant land.¹⁰⁹ However, this requirement of the equitable test cannot be met where there is no dominant land.
- 11.6 The LCR refers to the Queensland Land Title Act 1994 which allows covenants in gross which must “relate to the use of” the land.¹¹⁰ They also note that this is “similar to a requirement that a covenant must “touch and concern” the land”.¹¹¹
- 12. Inconsistency between the Law Commission Proposal and the Draft Bill**
- 12.1 In its submissions, the Property Law Section proposed a requirement that the covenants relate to “the land in some way and not be merely personal covenants”. They should be covenants “burdening land” within the meaning of s302 (1) of the Property Law Act.¹¹²
- 12.2 Whilst the LCR sets out that the equitable test (that the covenant must “touch and concern the land”) should apply¹¹³, s307A (b) of the Land Transfer Bill “requires the covenantor to act or to refrain from acting in a particular way in relation to the occupation or use of the land or part of the land”.
- 12.3 As set out above, in order to “touch and concern the land”, the covenant must regulate what can or cannot be done **on** the servient land. This can be in a number of ways such as:
- (a) Prohibiting certain activities or buildings on the land;

¹⁰⁵ LCR at para 7.35

¹⁰⁶ LCR at para 7.39

¹⁰⁷ LCR at para 7.49

¹⁰⁸ LCR at para 7.50

¹⁰⁹ *Ceda Drycleaners Limited v Doonan* [1998] 1 NZLR 224

¹¹⁰ Para 7.45

¹¹¹ Para 7.46

¹¹² New Zealand Law Society Property Law Section, “Land Transfer Act Review – Government Response”, (11 October 2010)

¹¹³ LCR at para 7.39

(b) Requiring the servient owner to do something on the land.

12.4 There is a difference between the equity concept of *“touch and concern the land”* which relates to use on the land as opposed to the test proposed by the draft bill *“occupation and use of”* land in the draft Bill.

12.5 The wording of the Bill should be amended to mirror the equitable requirement that the covenant *“touch and concern the land”*.

13. Is the proposed wording in the Bill too restrictive?

13.1 Even if correctly reflected in the wording of the Bill, the requirement that the covenant *“touch and concern the land”* will restrict the use of the statutory covenant in gross. A number of the examples of the use of encumbrances set out above may not strictly speaking contain a covenant which touches and concerns the land. For example the covenant to join an owners’ association or other incorporated society, grant a right of first refusal to purchase the servient land or grant a power of attorney in favour of the encumbrancee.¹¹⁴

13.2 PLS suggested that an express provision be added to the Bill to the effect that the requirement to join an entity such as a residents’ or precinct society be deemed to relate to the occupation and use of the land.¹¹⁵

13.3 There is a need for certainty. It would not appear reasonable for an encumbrance to be negotiated at considerable expense only to have it defeated by future owners of the servient land.

14. Consequences for encumbrances remaining

14.1 The PLS raised in its submission the question whether existing encumbrances should be validated. It was suggested that perhaps only existing encumbrances coming within the criteria in the new legislation be validated.

14.2 The LCR has recommended a general power of the Court to *“remove covenants in gross where the covenant is contrary to public policy or any enactment or rule of law, or the Court considers removal to be just or equitable.”*¹¹⁶

14.3 The LCR refers to the public policy concerns arising where there is an imbalance of power and cites the example of a retirement village. The suggested power for the Court to review the covenant would allow any instances of imbalance of power to be addressed.

14.4 There are a number of instances where such review takes place currently. For example:

14.4.1 The DLR has the power to remove redundant or expired easements or profit à prendre.¹¹⁷

¹¹⁴ Based on examples given the article by R Thomas “Possible Hazards of Memoranda of Encumbrance” (1997) 8 BCB 1 at 2. Note however *Taylor Trading* as referred to above at note 69.

¹¹⁵ New Zealand Law Society Property Law Section, “Land Transfer Act Review – Government Response”, (11 October 2010)

¹¹⁶ LCR at para 7.56

¹¹⁷ Section 70 of the Land Transfer Act 1952

14.4.2 The ability to apply to the Court for the modification or extinguishment of easements and both positive and negative covenants.¹¹⁸

14.4.3 Section 221(3) of the Resource Management Act gives both the owner and territorial authority the ability to apply for the consent notice to be varied or cancelled.

14.5 The prospect of review ties in with the test in *Kreglinger* set out above that the collateral advantage must not be “*unfair or unconscionable*”.¹¹⁹ The ability to apply for review a statutory land covenant in gross would appear sensible -particularly given its potential longevity.

15. **Summary**

15.1 Encumbrances currently perform a role in securing covenants in gross. There are currently a number of alternatives to encumbrances but they are not without problems.

15.2 Given that encumbrances are mortgages, their current use creates problems for conveyancers and mortgagees and may limit the ability of home owners to obtain finance. There is also the question over whether they are redeemable.

15.3 As the proposed statutory covenants in gross are limited to where the covenants “*touch and concern the land*”, their potential application is narrower than the current use of encumbrances and therefore, taking into account the long history of their use to secure personal covenants, there is a need for wider wording in the Bill to cover the current applications.

¹¹⁸ Sections 316 and 317 of the PLA and their predecessor section 126G of the PLAR

¹¹⁹ Supra at note 51 at page 9

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