IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA400/2022
[2023] NZCA 173

BETWEEN	JOSHUA SAMUEL HÜRLIMANN Appellant
AND	PAUL ANTHONY LILLEY AND MELANIE JANE LILLEY Respondents

Hearing:	21 March 2023
Court:	Brown, Lang and Palmer JJ
Counsel:	M Freeman and R A Bull for Appellant D I Sheppard and A J R Sinclair for Respondents
Judgment:	17 May 2023 at 11.30 am

JUDGMENT OF THE COURT

A The appeal is dismissed.

B There is no order as to costs.

REASONS OF THE COURT

(Given by Lang J)

[1] The issue in this appeal is whether the High Court erred in refusing to exercise its power under s 317 of the Property Law Act 2007 (the PLA) to remove restrictive covenants registered against land now owned by the appellant, Mr Hürlimann. The respondents, Mr and Mrs Lilley (the Lilleys), had registered those covenants against the title to the land shortly before Mr Hürlimann acquired it.

Background

[2] The Lilleys owned a seven hectare rural property that they decided to subdivide into four sections. They proposed to retain one section for themselves and to sell the three remaining sections as lifestyle blocks. Mr Hürlimann entered into an agreement to buy one of those blocks.

[3] The agreement for sale and purchase (ASP) contained the following provision:

> 23. The Vendor agrees not to allow any land covenants, easements or Council consents to be registered over the Property without the prior written consent of the Purchaser. If the Purchaser objects to any of the proposed land covenants, easements or Council consents which are required to be registered on the title, the Purchaser may cancel this agreement and receive a full refund of deposit paid.

[4] The parties signed the ASP on 13 January 2020. At that stage titles to the subdivided sections had not been issued. After the agreement was signed the relationship between the parties remained cordial for some time. However, the relationship subsequently deteriorated for a variety of reasons. Matters were not improved when Mr Hürlimann lodged a caveat against the Lilleys' property in September 2020.

[5] At the point when Mr Hürlimann lodged his caveat the Lilleys had not indicated they intended to register any restrictive covenants against the title to the section to be purchased by him. However, on 22 October 2020, the Lilleys' solicitor sent an email to Mr Hürlimann's solicitor attaching a series of consent notices issued by the local territorial authority as well as some utility easements. These needed to be registered against the title to the land to be purchased by Mr Hürlimann before the new title could issue. In addition, the email attached a series of restrictive covenants that the Lilleys intended to register over the title to Mr Hürlimann's section. The covenants imposed significant restrictions on any building that might be erected on that land. These included a prohibition on the erection of any buildings "other than a new residential home" and imposed design and construction specifications for any home that might be built.

[6] Mr Hürlimann sought advice from his solicitor as to whether cl 23 of the ASP prohibited the Lilleys from registering the restrictive covenants. The advice was to the effect that it did not. After seeking further advice from his solicitors on matters of strategy Mr Hürlimann instructed them on 10 November 2020 to confirm that the restrictive covenants were acceptable to him.

[7] The title for the section to be purchased by Mr Hürlimann then issued with the covenants registered against it. On 13 December 2020 Mr Hürlimann instructed his solicitors to confirm to the Lilleys' solicitors that he approved the title of the section he had agreed to purchase. The sale of the section was ultimately completed on 29 June 2021.

[8] During the period leading up to settlement the relationship between the parties deteriorated further, with the Lilleys' solicitor advising Mr Hürlimann's solicitor in March 2021 that the Lilleys intended to register further restrictive covenants against the title to Mr Hürlimann's section. These would prevent the owner of the section from erecting any residential dwelling or other building on it. The reason given for this was that the section had previously been used as a dumping ground and the Lilleys held concerns about the stability of the land for building purposes. This prompted Mr Hürlimann to issue proceedings in the High Court seeking a variety of orders and declarations in relation to both sets of restrictive covenants. At that point the Lilleys elected not to register the second set of restrictive covenants.

[9] In the High Court Mr Hürlimann contended that cl 23 of the ASP did not permit the Lilleys to register the restrictive covenants. Alternatively, he argued that he had agreed to the covenants under duress and subject to illegitimate pressure exerted by the Lilleys. He also argued that the registration of the covenants amounted to an abuse of discretionary contractual power by the Lilleys. Finally, he sought an order under s 317 of the PLA extinguishing the covenants.

[10] On 20 July 2022 Isac J delivered a judgment in which he found against Mr Hürlimann on all the arguments he had raised.[1] As we have already observed, the only aspect of the judgment that Mr Hürlimann challenges in the present appeal is the

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1 *Hürlimann v Lilley* [2022] NZHC 1751, (2022) 23 NZCPR 496.

refusal of the Judge to exercise the power under s 317(1) of the PLA to extinguish or modify the restrictive covenants.

Relevant principles

[11] Section 317(1) of the PLA provides as follows:

> **317 Court may modify or extinguish easement or covenant**
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> (1) On an application (made and served in accordance with section 316) for an order under this section, a court may, by order, modify or extinguish (wholly or in part) the easement or covenant to which the application relates (the **easement or covenant**) if satisfied that—
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> (a) the easement or covenant ought to be modified or extinguished (wholly or in part) because of a change since its creation in all or any of the following:
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> (i) the nature or extent of the use being made of the benefited land, the burdened land, or both:
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> (ii) the character of the neighbourhood:
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> (iii) any other circumstance the court considers relevant; or
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> (b) the continuation in force of the easement or covenant in its existing form would impede the reasonable use of the burdened land in a different way, or to a different extent, from that which could reasonably have been foreseen by the original parties to the easement or covenant at the time of its creation; or
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> (c) every person entitled who is of full age and capacity—
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> (i) has agreed that the easement or covenant should be modified or extinguished (wholly or in part); or
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> (ii) may reasonably be considered, by his or her or its acts or omissions, to have abandoned, or waived the right to, the easement or covenant, wholly or in part; or
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> (d) the proposed modification or extinguishment will not substantially injure any person entitled; or
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> (e) in the case of a covenant, the covenant is contrary to public policy or to any enactment or rule of law; or
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> (f) in the case of a covenant, for any other reason it is just and equitable to modify or extinguish the covenant, wholly or partly.

[12] Mr Hürlimann relies only on s 317(1)(f). He contends it is just and equitable for the Court to modify or extinguish the covenant, either wholly or in part.

[13] Not surprisingly, the PLA does not provide any definition or guidance as to when it will be just and equitable to modify or extinguish a restrictive covenant. This no doubt reflects Parliament's intention that the Court should have the ability to make orders under s 317(1)(f) in deserving cases that do not fall within any of the preceding paragraphs. Before doing so, however, the Court must be satisfied that it is just and equitable that such orders be made.

[14] The leading authority on the application of s 317 is the judgment of the Supreme Court in *Synlait Milk Ltd v New Zealand Industrial Park Ltd*.[2] In that case the Court observed that the cases on s 317 show that a two-stage approach is generally adopted.[3] The court's first task is to determine whether one (or more) of the grounds contained in s 317(1) is made out. If so, the second task is to determine whether the discretion to extinguish or modify the covenant should be exercised.

[15] On the latter point the Court observed:

> [168] In *Re University of Westminster*, the Court of Appeal of England and Wales observed, in relation to the equivalent United Kingdom provision, that "[a] finding of fact that one or more of the statutory grounds exists is likely, of itself and without more, to provide a good reason or reasons for making an order". That appears to reflect the approach to cases under s 317 and its predecessors. Indeed, Mr Miles told us there are no New Zealand cases where the court, having found that one (or more) of the grounds in s 317(1) has been made out, has exercised its discretion to refuse to extinguish or modify the easement or covenant.
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> (Footnote omitted.)

[16] Relevantly for present purposes the Court also observed:

> [88] All of this does not mean that the importance of contractual and property rights can be ignored. But they must be considered in the factual context before the court, rather than as generic fetters on the court's discretion. Contractual rights may well be significant where the original parties to a covenant are still the parties at the time of the s 317 application. And concern about expropriation of property rights may arise where the s 317 applicant is a public body. These are just examples. We think it is important that each

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2 *Synlait Milk Ltd v New Zealand Industrial Park Ltd* [2020] NZSC 157, [2020] 1 NZLR 657.
3 At [67].

> application is considered on its own merits, without assuming these considerations arise in every case.
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> (Footnote omitted).

[17] Any appeal against a decision made at the first stage will be governed by conventional principles where a challenge is made to an evaluative decision. The appellant is entitled to the appeal court's assessment as to the correctness of the decision but bears the onus of demonstrating error on the part of the court below.[4]

[18] Any appeal against the exercise of the discretion at the second stage is governed by the principles that apply to appeals against discretionary decisions. This requires the appellant to demonstrate that the court below erred in principle in exercising its discretion or the decision was plainly wrong.[5] An error of principle will include the situation where the decision maker takes into account an irrelevant consideration or fails to take into account a relevant consideration.

The appeal

Failure to follow the two-stage approach

[19] Mr Freeman argues on Mr Hürlimann's behalf that the Judge failed to follow the two-stage approach referred to in *Synlait*. He contends the Judge decided how he would exercise his discretion without first determining whether it was just and equitable that an order under s 317 be made.

[20] The Judge dealt with the argument in relation to s 317 as follows:[6]

> [116] I consider the factors that have led me to conclude Mr Hürlimann made a free and informed decision to affirm the contract and accept the covenants would make it inappropriate to exercise the discretion in s 317. To do so would undermine the terms of the bargain the parties settled on, including the existence and scope of the covenants themselves.
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> [117] In particular, as I have already found:

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4 *Body Corporate 193056 v Paihia Property Holdings Corporate Trustee Ltd* [2021] NZCA 411, (2021) 23 NZCPR 125 at [48].

5 *Kacem v Bashir* [2010] NZSC 112, [2011] 2 NZLR 1 at [32], citing *May v May* (1982) 1 NZFLR 165 (CA) at 170 and *Blackstone v Blackstone* [2008] NZCA 312, (2008) 19 PRNZ 40 at [8].

6 *Hürlimann v Lilley*, above n 1.

(a) Clause 23 permitted Mr and Mrs Lilley to require restrictive covenants for their own benefit. That provision also provided that Mr Hürlimann could cancel the agreement if the covenants were not acceptable for any reason.

(b) Despite this, Mr Hürlimann made a careful decision with the benefit of sound legal advice to accept the covenants and affirm the contract.

(c) In doing so he obtained a practical benefit, namely an apparent increase in the value of the property he was to purchase.

(d) Mr and Mrs Lilley did not act irrationally, arbitrarily, capriciously or in bad faith when seeking to require covenants in relation to Lot 3. There was a reason for their decision to require covenants over Mr Hürlimann's property but not others in the development.

[118] In light of this, I am not satisfied that it is just and equitable to order removal of the covenants under s 317.

[21] Mr Freeman places considerable weight on the fact that the Judge began the passage set out above by stating that his earlier findings would make it inappropriate to exercise the discretion in s 317 in Mr Hürlimann's favour. However, the Judge concluded by stating that he was not satisfied it would be just and equitable to extinguish the restrictive covenants under s 317. Viewed overall, we consider the Judge concluded that Mr Hürlimann had failed to establish that it would be just and equitable for the Court to modify or extinguish the restrictive covenants. This meant there was no jurisdiction to make the orders Mr Hürlimann sought. The issue of how the Judge should exercise his discretion did not arise.

[22] In any event, the Supreme Court noted in *Synlait* that, if a Court finds that s 317(1)(f) is engaged, it must necessarily have determined that it would be just and equitable to modify or extinguish the covenant.[7] This meant the Court may be required to take into account at the first stage some of the considerations that are also relevant at the second stage. We accept Mr Sheppard's submission for the Lilleys that in cases solely based on s 317(1)(f) a blended approach may be appropriate. We are satisfied there was no error in the Judge's approach.

[23] This ground of appeal fails as a result.

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7 *Synlait Milk Ltd v New Zealand Industrial Park Ltd*, above n 2, at [67] n 30.

The restrictive covenants are inherently inequitable and arbitrary

[24] Mr Freeman contends that the registration of the covenants against Mr Hürlimann's section alone was an inherently inequitable and arbitrary act by the Lilleys. This argument relies on the fact that the Lilleys have not registered any restrictive covenants against the titles to the other sections in the subdivision. Further, they have advertised the other two sections as being sold free of any restrictive covenants.

[25] Mr Freeman says that this has led to a situation in which the Lilleys have dealt with Mr Hürlimann in a manner that is both arbitrary and unfair. He points out that the Lilleys dealt with prospective purchasers of the other two sections differently to the manner in which they dealt with Mr Hürlimann. They asked those parties to provide copies of plans of houses they proposed to erect on the sections. They did not engage with Mr Hürlimann in the same way.

[26] Mr Freeman also points out that buildings have now been constructed on one of the other sections that would breach the covenants registered against the title to Mr Hürlimann's land. The original purchaser of the remining section has now on-sold the section to a third party. The new owner of that section is not bound to erect buildings on it using the plans shown to the Lilleys by the original purchaser.

[27] In addition, Mr Freeman points out that the Lilleys originally sought to justify the restrictive covenants on the basis that they would contribute to the establishment of a modern and well-designed subdivision that would be for the benefit of all the owners of sections in the development. Mr Freeman says this objective has now been thwarted by the fact that the remaining sections in the subdivision are not subject to any restrictive covenants at all.

[28] We respond to these submissions in three ways. First, cl 23 of the ASP did not prevent the Lilleys from registering restrictive covenants against the title to the section to be purchased by Mr Hürlimann. Mr Freeman's argument therefore appears to proceed on the basis that the Lilleys were subject to some form of equitable obligation to ensure that all the sections they were selling would be subject to restrictive covenants similar to those registered against the title to Mr Hürlimann's section.

That is not the case. The Lilleys were free to deal with the remaining sections as they saw fit. Equitable principles were not engaged.

[29] Secondly, Mr Hürlimann was fully aware of the nature and scope of the restrictions that were being imposed on his section and he expressly agreed to them after taking legal advice and considering his options. His solicitor had also advised him that the same covenants may not be imposed on the other sections in the subdivision. Mr Hürlimann nevertheless elected to continue with the purchase rather than exercise his right to cancel the agreement and receive a refund of his deposit.

[30] Thirdly, any failure by the Lilleys to achieve their objective of creating a modern and well-designed subdivision cannot be due to the continued existence of the covenants registered against the tile to Mr Hürlimann's land. Rather, it lies in the fact that they did not ensure other similar covenants were registered against the remaining sections. As we have already pointed out, however, they did not have to deal with the remaining sections in the same way they dealt with that being purchased by Mr Hürlimann.

[31] Mr Freeman also placed considerable emphasis on observations made by Lang J in *Auckland Council v Analie Properties Ltd.*[8] In that case the owner of an office building in the Manukau City Centre sought removal of restrictive covenants that prohibited retail shops from being established on the ground floor of that office building. Lang J found that grounds existed to remove the covenants under s 317(1)(a)(iii), (d) and (f) of the PLA. He then exercised his discretion to remove the covenants.[9]

[32] Mr Freeman relies upon the following passage in *Analie* as supporting his argument that the restrictive covenants in the present case should be removed because the Lilleys imposed them unfairly and arbitrarily:[10]

> [108] The first relevant factor in this context flows from the fact that, although the site development plan and other documents referred to the office development being part of a general scheme, the imposition of the restrictive

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8 *Auckland Council v Analie Properties Ltd* [2022] NZHC 269, (2022) 22 NZCPR 872.
9 At [114].
10 *Auckland Council v Analie Properties Ltd*, above n 8.

> covenants does not appear to have been an integral or significant feature of that scheme. If the prohibition on shopping in the office building development was to be an integral or significant component of the scheme, one would expect to see the same restrictive covenant registered against the titles to all parcels of land within that development. However, as I have already observed, this has not happened. Several parcels of land in the office building development are not subject to the restrictive covenant. There is no obvious explanation for why this has occurred, nor is there any explanation for why Fletcher Mainline required covenants to be registered over the titles to some lots but not others. In the absence of a logical explanation, the imposition of covenants appears to have been both random and arbitrary.

[33] However, these observations were made within the section of the judgment dealing not only with s 317(1)(f) but also with s 317(1)(a)(iii), which permits the Court to remove a covenant if circumstances have changed since the restrictive covenants were created. *Analie* was concerned with restrictive covenants that had been registered to protect shops in a newly-developed retail shopping centre from being subject to competition by retailers in an adjoining office building development. Lang J found that this objective had been achieved many years earlier.[11] His observations as to the apparently random and arbitrary nature of the covenants must be viewed in that light. We do not consider they provide any assistance in the present case.

[34] This argument fails as a result.

Collateral purpose

[35] Mr Freeman renews an argument, rejected in the High Court, that the Lilleys imposed the restrictive covenants for a collateral purpose, namely to force Mr Hürlimann to cancel the contract to purchase the section. The Judge dealt with this issue as follows:[12]

> [97] While there is some initial force in Mr Freeman's argument that the covenants operate unfairly because they only affect Mr Hürlimann's property, I accept Mr Lilley's evidence that the nature of his interactions with Mr Hürlimann, his partner and their families gave rise to a concern on his part (whether warranted or not) about what they proposed to build on [Mr Hürlimann's property].
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> [98] Mr and Mrs Lilley remain living on Lot 1 and are situated virtually opposite Mr Hürlimann's property. While ordinarily one might have expected covenants of a uniform nature to have been imposed on all of the lots in the

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11 At [110].

12 *Hürlimann v Lilley*, above n 1 (footnotes omitted).

> subdivision, Mr Lilley's evidence is that he had satisfied himself about the likely use by other purchasers of their lots through a pre-contractual vetting process. He did not have any concerns about what they proposed to build.
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> [99] In contrast, Mr Hürlimann was in his 20s, was a first home buyer, had no construction experience "and did not provide us with any reassurance that the type of home he wanted to build would be of adequate quality for the subdivision".
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> [100] It follows, in my view, that while Mr Hürlimann may feel that the Lilleys' decision to require restrictive covenants on his lot is unfair, their evidence is that they had — in their view at least — properly held concerns that warranted the imposition of the covenants. Despite Mr Freeman's robust cross-examination of Mr Lilley, he was not shaken from his evidence that it was these concerns, and not some improper motive, that was the genesis of the requirement for the restrictive covenants.
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> [101] In those circumstances, while there is a distinct possibility Mr and Mrs Lilley may have hoped the first set of restrictive covenants would cause Mr Hürlimann to cancel the agreement, there was no guarantee that would be the outcome. More importantly, there is no evidence on which to safety conclude that hope was their real aim.
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> [102] Even if I had found that the Lilley[s'] real purpose was to trigger Mr Hürlimann's right of cancellation because they no longer wanted him to purchase the lot, I would have been slow to find that was something they were not entitled to do. The agreement permitted Mr and Mrs Lilley to require restrictive covenants. Mr Hürlimann could either accept the covenants, seek to negotiate better terms, or cancel the agreement. It is generally not appropriate for the Court to police the underlying commercial motives of parties exercising a contractual power in these circumstances, or to impose its own view of what is reasonable.
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> [103] As it is, the covenants did not force Mr Hürlimann to cancel the agreement. He made an informed decision to accept them based on legal advice. It is clear his decision was not the product of illegitimate pressure or duress. [His solicitor's] file notes reveal Mr Hürlimann was aware of the options available to him, including cancellation or seeking to negotiate amendments to the covenants. He made the decision to accept them because he believed he could on-sell the section even with the covenants for a profit. None of that sounds in an abuse of a discretionary power.

[36] We see no basis on which to differ from the Judge on these factual issues given that he had the benefit of seeing and hearing the witnesses give evidence and be cross-examined. Nor do we detect any error of principle in the approach the Judge took. As we have already observed, the Lilleys were free to deal with their land as they wished. Clause 23 did not preclude them from registering restrictive covenants against the section Mr Hürlimann had agreed to buy. Further, the covenants did not force Mr Hürlimann to cancel the contract. He elected to continue with the purchase

because he was motivated to realise the profit generated by the increase in the section's value.

[37] Mr Freeman also argues that the Judge ought to have given greater weight to the fact that the Lilleys sought to register the second set of restrictive covenants given that these would have prevented the owner of the section from erecting any buildings on it. He complains that the Judge appears to have treated the attempt to impose the second set of covenants as an isolated aberration. The Judge noted only that, while the second set of covenants may have been an effort to force Mr Hürlimann to cancel the contract, Mr Hürlimann opposed the covenants and they were ultimately abandoned.[13]

[38] Like the Judge, we accept that it is at least arguable that the Lilleys sought to impose the second set of covenants because they wished to sever their contractual relationship with Mr Hürlimann. By this stage the parties were in conflict over the caveat Mr Hürlimann had lodged against the title to the Lilleys' property and their relationship had deteriorated significantly. It is perhaps not surprising that the Lilleys may have been anxious not to have Mr Hürlimann as their neighbour.

[39] Even if this was the case, however, the attempt by the Lilleys to impose the second set of covenants was ultimately unsuccessful and caused Mr Hürlimann no loss. We do not consider it to be sufficient to justify disturbing the Judge's conclusions as to the reasons why the Lilleys registered the first set of covenants. Further, the contractual rights afforded to the Lilleys under cl 23 also lead us to share the Judge's tentative view that the Lilleys were entitled to register restrictive covenants against the land regardless of their motivation for doing so. As he observed, it is not for the courts to police the underlying commercial motives of parties exercising a contractual power or to make findings as to what contractual terms are reasonable in all the circumstances.

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13 *Hürlimann v Lilley,* above n 1, at [86].

Our assessment

[40] Like the Judge, we consider the determinative factor in the present case to be the fact that Mr Hürlimann consented to the registration of the covenants with full knowledge of their nature and effect. He also received competent legal advice throughout regarding the options that were open to him and their respective ramifications. Mr Hürlimann ultimately elected not to cancel the agreement because he knew the section had increased significantly in value since he had agreed to buy it. As the Judge found, Mr Hürlimann wanted to take advantage of this by on-selling the property even though it would be subject to the restrictive covenants.

[41] We are therefore satisfied the Judge was correct to conclude it would not be just and equitable to make an order extinguishing the covenants.

Modification of the covenants

[42] Mr Freeman argues that, if the Judge was not prepared to extinguish the covenants, he ought to have given consideration to modifying them. He could, for example, have extinguished the most restrictive of the covenants.

[43] The Judge dealt with the issue of modification as follows:[14]

> [120] Finally, the power in s 317 is to extinguish *or modify* the covenants. Given I have concluded some of the covenants do not appear to be unreasonable, I would not have found it just and equitable to extinguish the covenants in their entirety. Modification would be a more appropriate response to specific concerns, but the case was not presented to me on this basis, and I have no evidence on which to make an assessment of the individual terms, or their impact.

[44] The problem with this aspect of the argument is that Mr Hürlimann did not identify how the Judge ought to have modified the covenants. Rather, he ran the case in the High Court on an "all or nothing" basis. This is not surprising given that the prayer for relief in the Statement of Claim sought only an order removing the covenants. This meant the Judge did not have any evidence as to why particular covenants should be extinguished and others preserved. We are in the same position. Mr Freeman did not attempt to identify how the covenants should be modified if they

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14 *Hürlimann v Lilley*, above n 1.

were not to be wholly extinguished. It is not for this Court to determine which covenants should be varied or extinguished when that issue has never been canvassed by Mr Hürlimann.

Result

[45] The appeal is dismissed.

Costs

[46] Mr Hürlimann is legally aided. No order for costs may be made against him unless there are exceptional circumstances.[15] Mr Sheppard argued that there were exceptional circumstances in the present case so as to justify an award of costs in favour of the Lilleys but we do not consider accept that submission. There was nothing about the circumstances of the appeal to make it exceptional so as to justify an award of costs. We therefore make no order as to costs.

Solicitors:
Thomas Dewar Sziranyi Letts, Lower Hutt for Appellant
Cooper Rapley Lawyers, Palmerston North for Respondents

[15] Legal Services Act 2011, s 45(2).