Terminating tenancies following failure to renew

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The recent High Court case of *Wendco (NZ) Limited v LJCTB Trustees Limited and CQB Trustees Limited*[1] involved a blatant failure by a tenant to renew its lease and demonstrates just how far the Court's discretion can stretch to require a landlord to grant a renewal of lease. The judgment is an important one for property lawyers to be aware of in order to advise landlords of the risks inherent in reletting a property following termination of the prior tenant's tenancy due to failure to renew.

Background facts

Wendy's[2] leased one of its fast-food restaurant premises in Auckland under a deed of lease which commenced on 5 August 2003, had an initial term of 12 years and two rights of renewal (for eight and four years respectively). Rent was ratcheted to the commencing rent of $155,000 plus GST.

The lease had the standard requirement to notify the landlord of intention to renew 3 months prior to the renewal date (i.e. by 5 May 2015). Just prior to this, on 30 April 2015, Wendy's wrote to the landlord advising that Wendy's was 'considering renewing the lease'. However Wendy's added that, due to the recent Waterview Tunnel, traffic to the restaurant premises had decreased. It therefore asked the landlord if it could renew the lease on the basis of four 2-year renewal periods or alternatively, for the rent to decrease to $100,000 plus GST per annum. This proposal was not accepted and the landlord issued its valuation for a rent increase to $166,250 plus GST.

The lease expiry date of 5 August 2015 came and went, and Wendy's continued to operate its restaurant from the premises. It noted in an email to the landlord on 30 October 2015 that it was a month-to-month tenant. The landlord, too, noted by email (on 24 May 2016) that Wendy's was a month-to-month tenant and that the parties were at an impasse.

On 1 February 2017, some 19 months after the renewal date, the landlord gave notice terminating Wendy's periodic tenancy.

Wendy's disputed that the landlord was entitled to terminate the tenancy arrangement and tried to negotiate with the landlord for a renewal. The landlord refused to accept the renewal and so Wendy's filed for relief pursuant to section 261 of the Property Law Act 2007.

Decision

The Court reflected on the 'very wide discretion' given to it under section 264 of the Property Law Act 2007 which effectively enables it to 'do what it thinks fit in accordance with the justice of the particular application'. The underlying rationale of the legislation is to protect a tenant from

CURRENT STATUS OF THE AUP, AUP CHANGES AND INTERPRETATION ISSUES AND THE GOVERNMENT'S ENVIRONMENTAL PRIORITIES *Continued...*

On freshwater, he is promising to release a new and more comprehensive National Policy Statement. Two of the Government's key planks for addressing climate change are the introduction of a Zero Carbon Bill (expected to be later this year) and the establishment of an independent Climate Change Commission. To tackle housing affordability, the Government is developing an Urban Growth Agenda, which will include the establishment of an Urban Development Authority.

In addition to those initiatives, the Minister confirmed he has work underway to identify the worst of the 2017 amendments to the RMA that may need to be reversed or corrected. He noted that key amongst those will be the restrictions on appeal rights and public participation that were introduced. This will be coupled with considering a comprehensive, longer term review of the overall resource management system (not just the RMA) later this year.

The Minister has already acted on his reform initiatives by introducing legislation to enable the cost of Board of Inquiry hearings under the Exclusive Economic Zone and Continental Shelf (Environmental Effect) Act 2012 to be recovered from applicants. A further bill addressing the worst of the 2017 amendments to the RMA is expected to be introduced later in 2018, in conjunction with progressing the Urban Development Authority proposal. We will provide further updates regarding both, as they become available.

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their landlord 'taking commercial advantage of their inadvertent mistake, where to do so would have a disproportionate effect on the lessee'.[3] The Court also reiterated the seven key factors for the exercise of discretion under section 264, as listed in *Ponsonby Mall Trust Ltd v New Zealand Food Industries Ltd*[4]:

- Reasons for the failure to give notice e.g. whether inadvertent;
- If the landlord had done anything to cause the default;
- The tenant's conduct, especially whether it had been a good tenant;
- Prejudice to the tenant if relief not granted;
- Prejudice to the landlord if relief not granted;
- The landlord's motivations for refusing to renew and understanding of the tenant's intentions;
- The interests of third parties, and how they may be affected.

None of these factors is necessarily determinative, and all factors must be weighed and considered in light of the particular circumstances in which they arise.

Wendy's submitted that the Court should exercise its discretion to renew the lease on the following grounds:

The circumstances surrounding Wendy's failure to give notice was clear that Wendy's had no intention to vacate the premises, and the Lessor's conduct added to Wendy's belief that the lease would be renewed

Wendy's argued that notice of its intention to renew the lease was not given as they believed the parties were merely negotiating terms such as rent, and that the landlord would allow the renewal once negotiations concluded. The landlord, however, argued that Wendy's failure to give notice was wilful and deliberate; engineered to secure more advantageous lease terms. The Court accepted the landlord's argument, noting that Wendy's is a sophisticated commercial party: Wendy's was seeking a reduction of rent contrary to a ratchet clause in the lease, and had taken the hard-line approach that it would only renew if the rent was decreased or the lease varied to provide four 2-year renewal periods.

Wendy's is a good tenant with a stable relationship with the Lessor

Wendy's submitted that it is a good tenant, is financially secure and can meet all obligations as they fall due. The landlord argued that there had been persistent disputes or breaches by Wendy's over operating expenses, which caused ongoing stress to the landlord. However, the Court regarded that, while this made Wendy's pedantic or difficult, it was still an acceptable tenant.

Prejudice to the parties and detrimental effect on third parties dependent on whether the lease is renewed or not

Wendy's noted its prejudice would relate to its investment in the premises of roughly $1,000,000 for construction and fit-out, and weakened bargaining power and higher average costs with its suppliers if it lost this restaurant site. They further noted loss of custom and goodwill due to a likely inability to relocate to a nearby site.

The landlord, on the other hand, submitted that they had expended $30,000 in obtaining a new tenant. This was however a prejudice that could be addressed simply by requiring Wendy's to compensate the landlord for this loss.

The Court instead focused on the detrimental effect on third parties: if the lease was not renewed, 24 part-time staff would be made redundant.

Despite the circumstances surrounding Wendy's failure to give notice and, in particular, the fact that it was deliberate and used to try and leverage a commercial advantage, the Court weighed the relative prejudice to both parties in deciding to exercise its discretion to renew the lease. Of significance was that the landlord's prejudice was able to be compensated for, whereas Wendy's employees would suffer a prejudice that could not be addressed if the lease was not renewed. As a condition for renewal, Wendy's was to compensate the Lessor for costs connected with obtaining a new tenant.

Commentary

The Court stated that the circumstances of this case were the outer limits of when relief will be granted under section 264, but it just goes to show how far-reaching this discretionary power is. This was not a case of an inadvertent failure to give notice of renewal at the right time: this was a commercially savvy tenant, who was aware they had become a monthly tenant and yet continued (for almost 20 months after lease expiry) to try to secure better lease terms than it had originally signed up for.

The case is in stark contrast to the Court of Appeal decision in *Pascoe Properties Ltd v Attorney-General*[5] which involved a tenant trying to avoid being bound by accepting a renewal. As in the Wendy's case, the tenant had tried to negotiate variations to the lease as part of its renewal. The tenant was successful, however, in arguing that it was not bound by the renewal because the parties had never formally concluded the variation of lease.

The key lesson from this case is to caution landlords, following termination of a lease for failure to renew, that tenants have a 3 month window within which they can seek relief from the Court, and that that application is mostly likely to be successful if the tenant can show they have been an acceptable tenant and can continue to pay the rent.

1. [2017] NZHC 2668
2. Wendco (NZ) Limited
3. At [17]
4. (2005) 7 NZCPR 48 (HC)
5. [2014] NZCA 616

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