

Legal Update | Property

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Further Information

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middletons | *straight talking*

Beware when interpreting restrictive covenants

In the recent decision of *Jessica Estates v Lennard* [2007] NSWSC 1175 and 1434 (Jessica Estates Case), the Supreme Court of New South Wales (Supreme Court) considered whether a clause in a local environmental plan enacted under section 28 of the *Environmental Planning and Assessment Act 1979* (EPA) rendered a private restriction over a land void.

After determining that the restrictive covenant was effective, the Supreme Court in the Jessica Estates Case ordered that a semi-detached duplex be modified so that it only contained one dwelling in order to enforce that restrictive covenant.

Facts

The facts of the Jessica Estates Case were as follows:

- Jessica Estates Pty Limited (Jessica) developed the Hunterview Estate and sold a lot in the subdivision to Mr and Mrs Lennard (Lennards).
- The Lennards' lot was subject to a section 88B instrument including restrictions that the registered proprietor of a lot must not, without the consent of Jessica, construct more than one dwelling on the lot, construct a semi-detached duplex or subdivide the lot (Restrictive Covenant). The Restrictive Covenant benefited all of the lots in the subdivision as well as Jessica as developer of the Hunterview Estate.
- After the purchase, the Lennards wrote to Jessica seeking consent to build a duplex because that 'was the main reason [they] purchased [the] block'. Jessica did not give its consent, explaining that the Lennards were aware of the Restrictive Covenant when they bought the lot and that they should have bought another lot which allowed them to build duplexes if their intention was to build a duplex.
- After receiving Jessica's refusal, the Lennards then obtained legal advice on their position. Their lawyer gave advice to the effect that despite Jessica's refusal of consent, they were entitled to build a duplex because clause 6 of the Singleton Local Environmental Plan (LEP) (enacted under section 28 of the EPA) suspended the operation of instruments, including restrictive covenants, that prohibited development which was permitted under the LEP.
- Clause 6 of the LEP provided that: "If in any agreement, covenant or similar instrument prohibits a land use allowed by this plan, then it shall not apply to that land use (to the extent necessary to allow that land use)".
- After receiving the legal advice the Lennards then lodged a development application (DA) with Singleton Council (Council)

for the construction of a duplex on the property and for a strata subdivision of that lot. The Council subsequently gave its consent to the DA.

- Jessica then wrote to the Lennards' builder, warning that any attempt to build a duplex would be in breach of the Restrictive Covenant and would be vigorously opposed. The Lennards' lawyers responded that Council's consent to the DA overrode the Restrictive Covenant due to clause 6 of the LEP and section 28 of the EPA.
- In subsequent correspondence Jessica maintained its position that it had not consented to building a duplex. The correspondence requested that the Lennards immediately cease work on the construction and that proceedings for injunctive relief would be commenced if they did not cease to construct.
- By the time the matter was heard in Court construction of the duplex was complete.

Court's decision

The Supreme Court of New South Wales held that:

- The Restrictive Covenant was not rendered void due to the operation of clause 6 of the LEP. Whilst the Restrictive Covenant was a 'prohibit' activity, the restrictions in relation to the construction of a duplex and strata subdivision did not qualify as a 'land use' as referred to in clause 6 of the LEP but rather a 'development'.
- The Lennards had breached the Restrictive Covenant by constructing a semi-detached duplex without Jessica's consent and in doing so there was serious infringement of Jessica's rights.
- Despite not being the owner of any of the lots in the subdivision, Jessica had a legitimate interest in preserving the amenity of the estates it developed.
- The normal remedy for a threatened or actual breach of a restrictive covenant is an injunction. However, a court can exercise its discretion to award damages in lieu of an injunction.
- The court held that damages were not a sufficient remedy for breach of the Restrictive Covenant. The loss of amenity and effect on Jessica's reputation was not readily compensable in monetary terms.

- While the Lennards' conduct could not be described as a 'flagrant disregard' of Jessica's rights it was certainly 'highly imprudent'. Having been refused consent by Jessica in relation to the construction of a duplex, the Lennards sought and obtained the development consent and the DA and started to construct without any further correspondence with or notice to Jessica. The Lennards knew it would be sensible to wait and resolve the issue before commencing building works.
- In light of the above circumstances, the semi-detached duplex had to be modified so that it contained only one dwelling. The estimated cost of these modifications was \$40,000.

Practical Tips

A restrictive covenant over a private land and a section 28 clause in a local environmental plan must be read together to ascertain whether and to what extent the restrictive covenant is rendered inapplicable by virtue of the local planning laws. This case illustrates that section 28 clauses are interpreted quite strictly so as not to affect anything more than necessary for the purpose of the development allowed in the local planning laws.

This case also illustrates that disregarding the risks involved and proceeding to construct can be very costly. Courts will generally award injunctions for the breach of a restrictive covenants unless there are very good reasons for exercising a discretion to award damages.

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Deposit Bonds Tips

Here's a brief guide to provide some background information and some practical tips for using deposit bonds

Deposits

In contracts for the sale of land, a purchaser is normally required to pay to the vendor a 10% cash deposit to provide the vendor with some security if the purchase does not complete due to the purchaser's default. On settlement the deposit is treated as part payment of the purchase price. The deposit is usually held in trust by the vendor's solicitor or agent as an independent stakeholder in the transaction and is only released to the vendor on settlement of the property. If the purchaser fails to settle due to the purchaser's default, then the vendor will normally be entitled to keep the deposit as a penalty for breach of the contract.

What is a deposit bond?

A deposit bond is in effect a written guarantee given to the vendor in place of a cash deposit for all or part of the deposit. The deposit bond is usually issued by a financial institution or an insurance company for a premium of around 1% of the deposit amount. Unlike a cash deposit which the agent holds in trust, deposit bonds are usually held by the purchaser's lawyers and returned to the vendor at settlement.

How does a deposit bond work?

If the purchaser defaults and the settlement does not occur the vendor may demand the issuer to pay the amount of the bond to the vendor. Usually the issuer is then irrevocably and unconditionally

authorised to pay the vendor and the issuer has no duty to enquire whether the vendor's claims are valid. This means that even if the purchaser protests that the vendor's claims are not valid, the issuer will have to pay the amount of the bond to the vendor when the vendor demands that the issuer pay. The issuer will then usually seek the amount of the bond from the purchaser who has to pay on demand. This is called a "counter indemnity".

Practical tips on using deposit bonds

Always check with the vendor to make sure that they will accept a deposit bond.

If a vendor is relying on the early release of the deposit from the sale it may refuse to accept a deposit bond. If the vendor is taken by surprise at the delivery of a deposit bond in place of a cheque for a cash deposit, the vendor is entitled to demand that the terms of the contract be honoured and may allege breach of the contract. This is because deposit bonds are not recognised as true deposits. Contracts will require the addition of special conditions to deal with deposit bonds since the standard clauses do not cover their use.

Carefully read the conditions of the bond to ensure it adequately protects all parties.

Expiry date

Look out for time limits imposed on deposit bonds. A deposit bond usually expires when the contract is completed, terminated,

rescinded or the expiry date occurs, whichever happens first. In some instances where settlement is delayed the deposit bond may expire, which will leave a vendor with no security.

Conditions

The conditions imposed on the deposit bonds may vary from institution to institution. You should carefully read the conditions to make sure it adequately protects all parties. Seek legal advice if you are not sure.

Conclusion

It is always prudent to read the conditions and expiry date imposed on deposit bonds. It is also good to consider who the deposit bond issuer is to ensure that they are reputable. While there are some risks and aspects to watch out for, if used correctly deposit bonds are a viable alternative to producing a 10% cash deposit on exchange of the contract.

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