COMMERCIAL LEASES

Refusing to renew a commercial lease – do it once, do it right

BY **MICHELLE HILL** AND **GEORGIA BEVERLEY**

IT MAY BE TEMPTING FOR A LANDLORD, who wants to refuse the renewal of a commercial lease with a difficult tenant, to reiterate the point. However, the recent High Court decision of *SGAH Investments Ltd v Mei Enterprises Ltd*[1] serves as a warning to landlords to just do it once, but do it right.

In *SGAH Investments Ltd v Mei Enterprises Ltd*, an application for possession following the expiry of a lease, two matters were explored before the Court. SGAH Investments Ltd (SGAH, as landlord of the commercial premises in Clendon, Auckland) sought possession of the premises on the basis the lease to Mei Enterprises Ltd (Mei) had expired, under s 244 of the Property Law Act 2007 (the Act). The second matter saw Mei seek relief against the refusal of SGAH to extend or renew the lease or grant a new lease to Mei, brought under ss 261, 262 and 264 of the Act.

Under s 261 of the Act, a tenant may apply for relief against a landlord's refusal to enter into a renewal of the lease. Under s 262 an application under s 261 must be made within three months from the date the landlord gives notice to the tenant of its refusal to renew the lease. Section 263 outlines the requirements of such a notice from the landlord.

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Two notices – which one counts?

Landlords need to be aware that issuing several s 263 notices may expand the time within which a tenant can bring a claim for relief against that. In this case the landlord sent two such notices to the tenant – one in August and one in September.

The August notice fulfilled the requirements of s 263 and informed Mei that it should be treated as a s 263 notice. However the September notice expressly referred to the statutory requirements of s 263, including the right to apply for relief lapsing if the application is not made "within 3 months of the date of service of this notice" and giving the date of the notice as "23 September 2020". Even though there was no evidence Mei thought the September notice substituted the August notice and that time ran from September not August, the Court turned to the statutory purpose of s 262 and 263 in determining the September notice as the relevant s 263 notice.

The purpose is to ensure that a tenant is properly informed of its rights and the statutory requirements it must satisfy to seek relief under s 261. Accordingly, allowing s 262 notices to be issued in a way that causes confusions is contrary to this purpose. A tenant needs to be clearly informed when time for seeking relief will expire. Therefore where there are two notices that both comply with s 263, the issue of each further notice extinguishes the earlier notice. Therefore Mei brought the claim on time, by filing the application for relief on 1 December 2020, within three months of the September notice.

Next step – should relief be granted?

Typically, if a landlord's refusal to renew a commercial lease is due to rent arrears, the Court will grant relief against a refusal to renew once the rent arrears are paid[2]. This is based on the principle that the landlord was prepared to contemplate the possibility of renewal at the outset. There are exceptions to this approach, which were unsuccessfully argued in this case. We will go through these now to demonstrate the high standard the Court requires before they will refuse to grant relief against a refusal to renew.

Tenant's conduct

SGAH argued Mei's breach of the lease twice, in failing to perform maintenance and subleasing the premises without SGAH's permission, warranted a refusal by the Court to grant Mei relief. The Court held that these concerns

are not serious or material enough to the performance of the lease to warrant refusing relief but rather are matters that can be addressed by the parties.

Prejudice to tenant if relief not granted

Mei argued it would suffer prejudice if not granted relief. The business, that had operated at the site for 20 years, had complied with all lease obligations and had 2 successful renewals already. Mei argued that the business cannot be relocated elsewhere and that it would not have paid the $840,000 for the business had it not been assured of a long-term lease. The lotto licence it has for its lotto shop was also tied to the premises. Mei said it would have lost the business if it couldn't operate the business from the premises. The Court held that Mei would suffer prejudice through loss of its business if the lease is not renewed.

In terms of the rent arrears, Mei argued that it stopped paying rent because it had lodged a claim that it was entitled to an extension of the lease, and believed that during this time it was entitled to set-off the rent against its claim. Mei, accepting that was wrong, since paid all rent arrears.

Prejudice to landlord if relief granted

When considering the prejudice to the landlord, the Court acknowledged Mei's refusal to pay rent prejudiced SGAH and was inexcusable at the time. The Court also noted SGAH's scepticism of Mei's promise to pay rent and the now damaged relationship between the parties. However since Mei had paid all rent arrears, it couldn't see what prejudice SGAH would suffer if relief was granted to Mei. The Court held the payment of the rent arrears had rectified any prejudice to the landlord.

Landlord's motivation for the refusal to renew the lease

A landlord's motivation for refusal is another factor that the Court will consider. Here the Court found that, since the rent arrears has been paid, one of the motives SGAH had to refuse to renew the lease was its scepticism that Mei will continue to pay the rent. It was held that since the rent had been paid there was no reasonable basis for refusing to renew the lease.

This goes to show that, even if a tenant refused to pay rent for months on end, and as a result the landlord lacks faith in the tenant paying rent on time in the future, if they eventually pay it back, the court will not give much weight to the landlord's skepticism.

Mei's bad behaviour

The final factor the Court considered was the risk that Mei would continue to behave badly as tenant. The landlord asserted that Mei displayed several occasions of bad behaviour including withholding rent and engaging in a series of "combative actions"[3] to pressure SGAH into extending the lease until 2044. This involved taking SGAH to Court on the basis the Landlord had promised Mei that the lease could be extended, letters of demand for payment from SGAH, a court proceeding in relation to a liquor store business operating within the same block of shops, issuing trespassing notices on SGAH's shareholders, threatening liquidation proceedings against SGAH without any legal basis and a private prosecution by the director of Mei for perjury against one of SGAH's shareholders. SGAH argued the conduct of Mei had left the relationship beyond repair. SGAH had also incurred costs greater than $27,500 in these matters.

The judge acknowledged that no landlord is likely to grant a 20-year extension to a lease with a Tenant who behaves as Mei did. However the absence of disputes since lease commencement, Mei's discontinuance of the liquidation proceeding and its payment of rent arrears, showed Mei had rectified its errors and could behave sensibly.

The judge therefore concluded that the tenant was entitled to relief under s 261 of the Property Law act 2007. The landlord was accordingly ordered to enter into a new lease with the tenant (in renewal) and the landlord's application for recovery of the property was dismissed.

Commentary

In other cases, neither disharmony and hostility between parties[4] nor high degrees of animosity[5] were enough to deprive a tenant of a right to renewal of a lease. This case further demonstrates the high standard the Court requires before it will refuse a tenant relief against a landlord's refusal to renew the lease and the importance of landlords ensuring they get the procedure right if wanting to insist upon their refusal to renew the lease. ■

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1. [2021] NZHC 1588
2. *SGAH Investments Ltd v Mei Enterprises Ltd* [2021] NZHC 1588 at [33]
3. *SGAH Investments Ltd v Mei Enterprises Ltd*, above n 1, at [60]
4. *Saisatnam Ltd v Brandons Trustee Co Ltd* [2017] NZHC 538, (2017) 18 NZCPR 215
5. *Arthur Devine v Highgate on Broadway Ltd* (2011) 13 NZCPR 276