Options in Leases – a further exegesis

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The grant of a lease may confer on the lessor some further right, at his future election, to extend his leasehold estate either in time or in nature from the end of the term immediately granted. Such additional rights[1] fall legally into two distinct types: the right to renew the term of the lease (an extension in time), and the option, strictly so-called, to purchase the freehold reversion (an extension in nature). Although there is, in general, a clear distinction between these two elective rights, it seems that the consequences for either type of option of the registration of the parent lease under the Land Transfer Act 1952 are identical.

If it can be said that the effect of registering an option-bearing lease is the same for either type of option, that effect must be clearly stated. Is it, as has long been believed to be the case, that registration of the lease confers a state of indefeasibility not only on the leasehold estate but on the further option itself, or is it otherwise? Can the validity of the option still be examined by the general law, despite registration? These questions, long thought to have been settled, seem now to have re-opened at a time when the wider dispute as to the general meaning of indefeasibility of registration has been quietened with the decision in *Frazer v. Walker*.[2] The object of this note therefore is to consider the effect on the previously understood law of recent decisions of the High Court of Australia.

I. THE EDWARDS' PRINCIPLE

At the beginning of this century, Edwards J. was the prime mover in establishing the well-known proposition, which survived all the intervening uncertainties surrounding indefeasibility of title, that an option in a lease acquired the same indefeasibility as the lease itself from the mere act of registering the lease.

The problem first came to the attention of Edwards J. in the form of an option to purchase the freehold in the case of *Rutu Peehi* v. *Davy*.[3] Here the parent lease derived from a transfer of Maori land which had been authorised by the Maori Land Court in excess of its jurisdiction. Under the legislation then governing Maori land the title of the lessor, and hence of the lessee, was void. Nevertheless, registration was held to validate all transactions, not only the ultra vires transfer and the lease itself, but also the option to purchase. Edwards J. found support for this result in the terms of the ancestral image of section 118 of the Land Transfer Act 1952 which provides specifically that a registered lease may contain an option to purchase the freehold, and that in such a case the

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1. Commonly called options. In this comment the word option will be used in this general sense.
2. [1967] N.Z.L.R. 1069.
3. (1891) 9 N.Z.L.R. 134.

lessee is entitled to have a transfer. In the course of his judgment His Honour commented:[4]

> In my opinion the rights so acquired by the lessee are as much protected as the term granted by the lease. To hold otherwise would work the grossest injustice, and would strike a dangerous blow at the utility of the Land Transfer Acts.

This case formed the foundation for the later flowering of the Edwards' principle in the leading case of *Fels* v. *Knowles*.[5] In this case the Court of Appeal by a majority[6] held that the registered proprietor of a lease containing an option to purchase the freehold was entitled, on the exercise of the option, to a decree of specific performance of the option notwithstanding that the option was given in breach of trust.

What seems to have attracted the majority of the court was the idea that registration gave an immediately indefeasible title to the lessee; that as Edwards J. emphasised in delivering the judgment of the majority:[7]

> The cardinal principle of the Statute is that the register is everything . . . Nothing can be registered, the registration of which is not expressly authorised by the statute. Everything which can be registered gives, in the absence of fraud, an indefeasible title to the estate or interest, or in the cases in which registration of a right is authorised . . . the right registered.

As in *Rutu Peehi* the court in *Fels* v. *Knowles* found in the legislative provision now appearing as section 118 of the Land Transfer Act 1952 specific authorisation for the registration of an option to purchase:[8]

> . . . the Legislature . . . has made a right to purchase contained in a lease under the Land Transfer Act an integral part of the lease itself, and that the registration of the lease is a registration of every right given by it.

On the question of the apparent sanctioning of a breach of trust, if this concept of indefeasibility were applied to the facts of *Fels* v. *Knowles,* the court observed that the breach of trust had already been perpetrated and that all the court was asked to do was to enforce indefeasible statutory rights honestly acquired.

Nor was there any backsliding from the Edwards' principle of option indefeasibility in the case, a few months later, of *Horne v. Horne*.[9] Although the result was here the reverse of *Fels* v. *Knowles,* the Court of Appeal resoundingly reaffirmed its earlier view, and explained the difference between the cases solely by reference to the facts of *Horne's* case where the lease and the option related

4. Ibid., 151.
5. (1906) 26 N.Z.L.R. 604.
6. Stout C.J. dissenting.
7. (1906) 26 N.Z.L.R. 604, 620.
8. Ibid., 621.
9. (1907) 26 N.Z.L.R. 1208.

only in part to registered land but included also land not within the land transfer system.

More recently the principle was applied by Johnston J. in *Rotorua and Bay of Plenty Hunt Club (Inc)* v. *Baker*[10] and thus a body of authority was established that the concept of indefeasibility extended not only to registered estates but also to options to purchase. What then of the second class of option, the right of renewal? In *Fels* v. *Knowles* Edwards J. acknowledged[11] that the two types of option were different and indeed no express statutory provision like section 118 of the Land Transfer Act 1952 can be found to support the right of renewal. However, the Edwards' principle expressed in *Fels* v. *Knowles* was readily applied to rights of renewal in *Roberts* v. *D.L.R. at Gisborne*[12] and *Pearson* v. *Aotea District Maori Land Board.*[13]

The rationale behind this extension seems to relate to the principle difference between the two types of option, as explained in *Mueller* v. *Trafford,*[14] that an option to purchase is an executory estate or interest *in futuro* (and thus needs specific mention in the Land Transfer Acts), while the right of renewal is an estate or interest ab initio and[15]

> . . . is adjectival in relation to the term granted. It constitutes a material qualification of the term, and is therefore something more than a mere ancilliary right. It is, in other words, an integral part of the estate shown by the Register as vested in the lessee. Its registration is, I think, in consequence authorised under the Land Transfer Act. That a right of renewal also creates an equitable estate in the land is in my view merely coincidental.

II. THE VLATTAS CASE — A BREAK IN UNANIMITY

Thus the Edwards' principle became firmly established, and was seen to be in apparent accord with the view of indefeasibility of title generally, as propounded later by the Privy Council in *Frazer* v. *Walker.* However, although Finlay J. dismissed the equitable nature of rights of renewal as merely coincidental, they, and options to purchase remained essentially equitable in nature, dependent as much on a decree of specific performance for their enforcement as on the fact of registration. This fact seems to have remained a nagging doubt in the judicial mind, expressed first and most clearly in the dissenting judgment of Stout C.J. in *Fels* v. *Knowles* that:[16] "Primarily, the Land Transfer System was only meant to validate completed transactions by registration".

It is clear beyond doubt that any option in a lease which needs a decree of specific performance for its completion is not a "completed transaction". But how much weight is to be given to the discretions of Equity in the face of

10. [1941] N.Z.L.R. 699.
11. (1906) 26 N.Z.L.R. 604, 622-623.
12. (1909) 28 N.Z.L.R. 616.
13. [1945] N.Z.L.R. 542.
14. [1901] 1 Ch. 54.
15. *Pearson* v. *Aotea District Maori Land Board* [1945] N.Z.L.R. 542, 551 per Finlay J. See also the observation of Gibbs J. in *Mercantile Credits Ltd.* v. *Shell Co. of Australia Ltd.* (1976) 9 A.L.R. 39, 50.
16. (1906) 26 N.Z.L.R. 604, 614.

registration especially as in each of the cases previously mentioned there was a degree of voidness attaching to the option?

An anwer to this question was suggested by the High Court of Australia in *Travinto Nominees Pty Ltd.* v. *Vlattas*[17] which involved an option to renew which was not only void but also illegal. In these circumstances, the High Court held that registration of the lease (also void and illegal) did not give the lessee any right to the benefit of the option to renew.

It was the fact that the lease and option were rendered illegal and subject to statutory penalties overriding the Torrens system which seems to have led the court to its final conclusion, so that as Gibbs J. observed[18]

> . . . it is unnecessary to consider . . . whether a covenant or option to renew should be regarded as an integral part of a lease so that the registration of the lease renders indefeasible the rights given by the covenant or option. I would therefore leave open the question whether the observations on this subject [in *Roberts*] and the decision [in *Pearson*] should be regarded as correct . . .

Despite this Barwick C.J. allowed himself to go further and to comment on the New South Wales equivalent of section 118 in the following terms:[19]

> It may be noted that the Real Property Act[20] recognises that there may be terms and conditions in the memorandum of lease . . . registration of the memorandum of lease does not ensure the validity of every covenant it contains. In my opinion it must depend on the nature of the covenant and its relation to the limitation of the interest created in the land by the memorandum of lease itself . . . The validity or enforceability of such a covenant will remain a question under the general law.

The almost inescapable inference to be drawn from these words is to cast doubt on the earlier New Zealand decisions, and to suggest that an option in a registered lease only enjoys a limited indefeasibility so that if there is any possibility that it is void or otherwise infringes the general law the discretions of Equity may be exercised against its enforcement.

III. THE MERCANTILE CREDITS CASE

This suggestion from the *Vlattas* case has recently been taken further by the High Court of Australia in *Mercantile Credits Ltd.* v. *Shell Co. of Australia Ltd.*[21] This decision not only develops the dicta in *Vlattas* (although the result is distinguished) but also approves the Edwards' principle without apparently endorsing the consequences as found in the results of the New Zealand cases.

The court in *Mercantile Credits* was concerned to determine the relevant

17. [1972-3] A.L.R. 1153.
18. Ibid., 1175.
19. Ibid., 1162.
20. Cp. s. 118 Land Transfer Act 1952.
21. (1976) 9 A.L.R. 39.

priorities of a lessee's option to renew and an assignment of a mortgage of the freehold, and particularly whether the option acquired indefeasibility by registration so that it would have priority over the assignment of the mortgage by prior registration. There was no question of the option itself being void or illegal (this was the ground for distinquishing *Vlattas* in fact), but if it had no indefeasibility then by N.S.W. legislation[22] it might be not binding on a mortgagee who did not consent.

This problem raised, as the Court was aware, the matter which had been left undecided in *Vlattas* — the correctness of the Edwards' principle, at least where the covenant or option was not illegal[23]

> In *Travinto Nominees Pty Ltd.* v. *Vlattas* . . . the court decided that a covenant which was illegal when made, obtained no validity or protection from the registration of the instrument in which it was found because its illegality denied the possibility of its specific performance. The position of covenants which are not illegal was left as an open question. It now falls for decision.

In the event the decision reached by the court was that registration of the parent lease did indeed confer a kind of indefeasibility on such a covenant, at lease sufficient to give an option priority over a later registered transaction. Nevertheless to obtain this status the option had to be part of a registered lease, a separately executed agreement or covenant which itself could not be independently registered had no indefeasibility.[24]

As to this decision generally Stephen J. made the comment that[25] "It is satisfying to note that the decision in this case will accord with the pattern of New Zealand decisions."

A somewhat optimistic observation, for the question remains — does it so conform? In *Vlattas* there was penal illegality, sufficient to enable that case to be distinguished both from the present case and the earlier New Zealand decisions. In all the New Zealand cases, there was some suggestion at least of a more general but lesser voidness. Neither illegality nor nullity appeared in the *Mercantile Credits* case.

In the above noted dictum of Barwick C.J. the clear distinguishing emphasis is on illegality. If left at that point the position might have been easy to restate: that illegal options unlike clean or merely void options obtain no enforceability. However in almost typical judicial fashion this clear view is clouded by qualifications. For after noting the effect of *Frazer* v. *Walker* that registration of an instrument, void under the general law, renders that instrument valid and indefeasible. Barwick C.J. stated that:[26]

> . . . the specific enforceability of the covenant for renewal, assuming its validity either under the general law or because of its presence in the

22. Of which there is no exact equivalent in New Zealand. Cp. s. 119 Land Transfer Act 1952.
23. (1976) 9 A.L.R. 39, 45, per Barwick C.J.
24. Ibid., 47 (per Barwick C.J.), 49 (per Gibbs J.).
25. Ibid., 57.
26. Ibid., 45.

> registered instrument, will be decided under the general law. The interest in the land derived from the covenant will be co-extensive with the extent to which the covenant could be ordered to be specifically performed.

But having thus shifted his ground from illegality to more general validity the learned Chief Justice later refers to the various New Zealand cases and asserts that:[27]

> My conclusion that the Act gives priority and indefeasibility to the right of renewal contained in the registered memorandum of lease in this case conforms to the time of decision in New Zealand . . . all of which cases, *insofar as* they decided that a memorandum of lease may contain a *right of purchase or of renewal* and that such rights having no *illegality in their creation,* obtain priority and indefeasibility by registration of the memorandum, were, in my respectful opinion, correctly decided.

All of which, while appearing to approve the New Zealand cases supporting the Edwards' principle subject to the qualifying words "insofar as", in reality leaves the whole question vague. As has already been noted, all the New Zealand cases had some hint of illegality or invalidity (if there is any distinction between these terms) — whether that illegality (but not criminality) was excess of statutory power, breach of trust or otherwise.

Of course Barwick C.J. was but one member of the court which decided *Mercantile Credits* v. *Shell Co.,* but the other members, Gibbs and Stephen J.J., do not shed much more light on the question of indefeasibility, but seem to prefer to evade this issue. Stephen J. bases his judgment essentially on statute especially the equivalent of our section 118, which in South Australia and New Zealand relates only to options to purchase and merely observes that[28] "it cannot be supposed that . . . a right of renewal will generally be treated less favourably."

On the other hand Gibbs J. concentrates on the narrower issue of priority although he does acknowledge a relationship between that issue and the issue of indefeasibility[29]

> The present case, unlike these two New Zealand cases (*Roberts* and *Pearson*) is not one in which the grant of the right of renewal was illegal or void and we are not concerned with a question of indefeasibility but with one of priority; although the two questions appear to depend on the same considerations, it is unnecessary to consider what the position would have been if the covenant had been void before registration of the lease. In my opinion the judgment of Finlay J. in *Pearson* v. *Aotea District Maori Land Board,* so far as it is relevant to the present case was correct. The right of renewal is so intimately connected with the term granted to the lessee . . . that it should be regarded as part of the estate or interest which the lessee obtains . . . and on registration is entitled to the same priority as the term itself.

27. Ibid., 47; italics added.
28. Ibid., 56.
29. Ibid., 51.

Again we find the qualified approval of the New Zealand cases "so far as it is relevant", so in the final analysis we must ask — where does this leave us? How far has the Edwards' principle been applied or approved by the High Court of Australia?

IV. CONCLUSION

From the Australian decisions two points at least emerge clearly:

1. Options which are not merely void but criminally illegal do not acquire any validity from the registration of the parent lease.
2. Options which are wholly valid retain their validity and enforceability by registration of the parent lease at least to the extent of gaining priority over later registered transactions.

More than this one cannot say with certainty because the priority of valid options perhaps derives not from some concept of indefeasibility but from express statutory provision in the one instance, or from being an integral part of, or qualification on the term in the other.

On the question of invalid options, other than penally invalid ones, the final answer may, as suggested by Barwick C.J. on two occasions, depend on the availability of specific performance. The New Zealand courts, it is true, automatically granted such a decree on establishing the validation of the option by registration but this might go too far. An option whether granted in a lease or otherwise remains as Adams observes[30] an irrevocable offer for a future contract and in itself is no more than an inchoate right which needs the assistance of Equity for completion. An option is not, as Stout C.J. so carefully observed[31] in an early dissenting judgment "a completed transaction". In these circumstances Barwick C.J. at least would wish to preserve to Equity something of the discretion inherent in all equitable remedies, and especially in the decree of specific performance.

On balance it may be that the Barwick view is preferable to the wider Edwards' principle as there would indeed seem to be no objection in principle why a mere covenant as opposed to an estate should be further tested. It would indeed be strange if an option in a lease, which might be void but not criminal, on some ground of public policy or for perpetuity,[32] should be automatically eligible for a decree of specific performance merely because it is contained in a registered lease.

The very nature of options would seem sufficient to place them in a different position on the scale of indefeasibility from other transactions. Although the Edwards' principle may have been an important factor in the development of the current theory and fact of immediate indefeasibility in general circumstances, where a person becomes the registered proprietor of a present estate, by honest participation in an invalid transaction, the time may now be right, with the settlement of the wider question, to view options in a more realistic perspective. To regard indefeasibility as applying only to final and completed transactions granting or conveying enforceable or executed estates, would seem to do no violence to the concept of indefeasibility as presently understood.

30. *The Land Transfer Act* (2nd ed. Wellington, 1971) 289.
31. (1906) 26 N.Z.L.R. 604, 614.
32. E.g. in excess of the strict terms of s. 17 Perpetuities Act 1964.