Leasing Newsletter

June 2009

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CBP is pleased to announce that Martin Deutsch, a highly respected commercial litigator with substantial specialist expertise in retail leasing and commercial property disputes, has recently joined the Commercial Dispute Resolution Group of the firm.

For over 20 years, Martin has acted for a number of publicly listed and multi-national corporations including shopping centre owners and managers, banks, insurers, manufacturers and various other commercial enterprises in relation to commercial disputes. He is highly experienced in conducting litigation in all major Australian jurisdictions, including the High Court, Federal Court and Supreme Court of various states. Martin's experience also extends to all forms of alternative dispute resolution and he is a mediator on the panel of the Retail Tenancy Unit.

As a recongised market leader in his field, Martin's expertise adds to the retail leasing and commercial expertise of our property group and significaly extends the expertise of CBP in handling all manner of leasing disputes, especially those relating to retail leases.

Tenant's destruction of landlord's foyer a "contumelious disregard" of landlord's rights

On 12 February 2009, the High Court of Australia unanimously dismissed an appeal by a tenant against the Full Court of the Federal Court's majority decision which awarded a landlord $1.38 million with costs against a tenant who, in "contumelious disregard" of the landlord's rights made extensive alterations to premises without the landlord's approval.

The case concerned an office building at 5 Bowen Crescent, Melbourne. Tabcorp had rented the office premises from the landlord Bowen Investments Pty Limited. Under clause 2.13 of the lease the tenant had promised "not without the written approval of the landlord first obtained (which approval shall not be unreasonably withheld or delayed) to make or permit to be made any substantial alteration or addition to the Demised Premises".

Before leasing to Tabcorp the landlord had constructed a high quality foyer made of special materials — San Francisco green granite, Canberra York gray granite and sequence matched crown cut American cherry panelling. Tabcorp signed a long term lease of the building on 23 December 1996 for a term of 10 years, commencing 1 February 1997. An option to renew for five years until 2012 was exercised and the new lease began on 1 February 2007 and should have eventually expired on 31 January 2012 where there was a further option to renew for five years.

On 14 July 1997, a director of the landlord company arrived at the building, and found the foyer of the building badly damaged. A glass and stone partition, timber panelling and stone floor tiles had all been removed. The director was shocked to see what remained of the floor stone work being jack hammered. A large bin was filled with debris from the foyer and this destruction had been carried out without any approval whatsoever.

The destruction and rebuilding of the foyer was completed despite many protests from the landlord.

Initially in the Federal Court of Australia, the only claim which the trial judge (Tracey J) upheld was a claim for common law damages in relation to two specific breaches of the lease by the tenant of that clause 2.13, being the destruction of the old foyer up to 14 July 1997 and the construction of a new foyer up to 31 August 1997. There was judgment in favour of the landlord for $34,820. This was calculated as the basis of the difference in the value of the property with the old foyer and the value of the property with the new upmarket and modern foyer built by Tabcorp. The assessment of damages was really a comparison of the lettable area of the foyer before and after the rebuilding of the foyer.

The majority of the Full Court of the Federal Court of Australia (Finkelstein and Gordon JJ) treated the breach by the tenant of clause 2.13 as analogous to the breach of a covenant to keep premises in good repair. The case of *Joyner v Weeks* was applied to give the landlord damages representing the amount it would cost to restore the premises to the original condition. The judgment sum was accordingly increased to $1.38 million which was comprised of $580,000, being the cost of restoring the foyer to its original condition and $800,000 for loss of rent while restoration was taking place.

The tenant then appealed to the High Court of Australia to seek restoration of the trial judge's sum.

The High Court dismissed the appeal. It took a different approach to the Full Federal Court, choosing to apply general principles of common law damages rather than *Joyner v Weeks* and the repair cases.

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The general rule for assessing common law damages is that wherever a party suffers loss arising from breach of contract that party is, so far as money can do it, to be placed in the same situation as if the contract had been performed.

The landlord's measure of damages for the breach of clause 2.13 was the cost of restoring the premises to the condition in which it would have been if the clause had not been breached. It was also held that it was not unreasonable for the landlord to insist on reinstatement damages. If the landlord had applied the damages to reinstate the premises at the end of the lease it would have had to take into account fair wear and tear over the duration of the lease in reducing the amount of damages. Unfortunately for the tenant, it only argued that no reinstatement damages were applicable so no reduction for fair wear and tear was made.

In New South Wales, section 133A of the *Conveyancing Act 1919* (NSW) overrides *Joyner v Weeks* and the repair cases. The effect of the provision is that if the tenant fails to keep the premises in repair, the landlord is only entitled to the difference in value of the reversion. Following the decision of the High Court, it is likely that making significant structural alterations in breach of the lease will not be considered to be a failure to repair.

Therefore, the courts will probably award a successful landlord damages representing the cost of restoring the premises to the original condition.

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Documenting leases

The recent Court of Appeal of the Supreme Court of New South Wales decision in *Azkanaad Pty Limited v Galanos Bros Pty Limited* highlights why it is crucial to properly document lease arrangements.

The parties held negotiations in 2002 with respect to the lease of a site. There was correspondence and a draft lease was submitted and negotiated but the terms were never finalised nor was the agreement for lease executed.

The lessee commenced work on the site which included the fitting out of a convenience store attached to a service station, erecting signage and other associated works. The lease commenced in March 2003.

The tenant commenced paying rent and trading from the site.

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The venture did not proceed successfully and the tenant fell into arrears. It made some lump sum payments towards the arrears and continued in occupation for more than a year after the landlord made a demand with respect to the arrears.

Notwithstanding the fact that the tenant had been operating a business from the site for five years and had been paying rent, the Court at first instance held that the correspondence and conduct of the parties was not sufficient to give rise to a binding lease arrangement.

The Court of Appeal agreed with the trial judge notwithstanding the period that the tenant had been in occupation.

In any event, the failure to pay substantial rent would have constituted a significant breach of any lease which would have been deemed to have come into existence and the Court would therefore not have granted specific performance of any such agreement in favour of the tenant.

Only one of the appeal judges thought that there was sufficient acts of part performance to constitute a lease but even this judge would not have granted specific performance due to the breaches by the tenant.

It is therefore crucial that the parties document fully the landlord and tenant relationship before occupation is taken by a tenant.

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Retail Leases Act and third parties

Does the Administrative Decisions Tribunal of New South Wales (ADT) have jurisdiction against third parties with respect to disputes relating to leases of retail premises?

This question was answered in the negative by the ADT in the matter of *Lyons Road Pty Limited v Owner Strata Plan 38722.*

A tenant wished to conduct a clothing retail business from two shops which were strata titled premises.

There were problems with asbestos contamination and water penetration and these were matters for which the Owners Corporation of the building was responsible.

The landlord had the Owners Corporation attend to these matters and the tenant then completed its fitout of the property and proceeded with the lease.

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The tenant's commencement of the lease was delayed because of this work and the tenant commenced proceedings against the landlord seeking damages. The landlord sought to join the Owners Corporation as it was a party that was responsible for the matters which caused the delay in the tenancy commencing. The landlord also sought to recover from the Owners Corporation its loss of rent for the period that the tenant was delayed in commencing to trade.

The Owners Corporation successfully argued before the ADT (both at first instance and on appeal) that the ADT did not have jurisdiction so far as the claim against the Owners Corporation was concerned. The ADT's jurisdiction only extends to "retail tenancy disputes". Whilst the landlord would appear to have had a legitimate claim against the Owners Corporation, it could only establish its claim by way of taking separate proceedings at common law in negligence and/or for breach of the obligations of the Owners Corporation in accordance with the *Strata Schemes Management Act*.

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