

# LITIGATION ISSUES IN RETAIL LEASES IN NEW SOUTH WALES

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## ABSTRACT

Large shopping centres continue to capture the imagination and the pockets of consumers throughout Australia and the modern cities of the world as they strive to provide the ideal answer to the one stop shopping phenomenon. More recently, New South Wales has experienced the growth in bulky goods warehouse retailing as a popular mecca for endless hours of retail therapy, whilst the young and fashion conscious have enthusiastically embraced the concept of DFS (Direct Factory Sales) marketing at less exotic retail venues. In November 2006 the worlds largest retail development, the Dubai Mall in Dubai, opened its doors with 1400 shops on a site that is the equivalent of 50 international soccer fields, reputedly surpassing the “8<sup>th</sup> Wonder of the World”, the Edmonton Mall in Alberta, Canada, which has 800 shops, 100 eateries and 493,000 square metres of space.

The NSW Government has, since the introduction of the *Retail Leases Act* 1994 (“the Act”) confirmed its intention to actively regulate the relationship between smaller retailers (lettable areas of less than 1000 square metres) and shopping centre landlords. Smaller retailers are generally not the anchor tenants of shopping centres but they provide high returns to landlords through rents and in many cases, a contribution from monthly turnover. In NSW, disputes between retailers and shopping centre landlords frequently occur over the payment of rents, fitouts, assignment of leases, options to renew and rent reviews based on market rent. These disputes fall within the jurisdiction of the Act and the Administrative Decisions Tribunal. This paper examines a wide range of recent disputes and the legal principles guiding their resolution. It also examines how the recent amendments to the Act (which commenced on 1 January 2006) will impact on future litigation prospects.

## INTRODUCTION

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The evidence from retail sales analysis would suggest that Australian consumers have enthusiastically embraced the development of retail shopping centres over the last quarter century. According to Property Council of Australia research, shopping centres account for 28% of the retail space in Australia yet generate 41% of total retail sales.<sup>1</sup>

The ambient shopping conditions provided by the 1338 shopping centres throughout Australia combined with aggressive in-store sales marketing have been successful in generating more than \$51 billion in annual retail sales, while shopping centres currently employ 5.5% or 1 in 20 of the Australian workforce.<sup>2</sup>

It is significant to note that nearly half (47%) of the 55,000 specialty stores in Australian shopping centres are owned and operated by independent traders who together with nationally branded retailers make up the complement of retail shops “in large regional centres of more than 100,000 square metres of retail space generating sales of around \$500 million a year, down to smaller, supermarket based centres of around 5,000 square metres generating sales around \$30 million.”<sup>3</sup>

The relationship between these small businesses and the shopping centre owners are regulated by retail tenancy legislation prescribed by the individual state or territory governments<sup>4</sup> and administered jurisdictionally by a framework of state or territory based specialist tribunals and Supreme Courts, supplemented by Federal Court jurisdiction where claims have attracted the provisions of the *Trade Practices Act 1974* (“TPA”) generally as a result of an alleged breach of s52 of the TPA (“misleading and deceptive conduct”). It is a fact of retail life that disputes occur frequently between

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<sup>1</sup> “Australian Shopping Centre Industry May 2000 - *Property Council of Australia, Australian Shopping Centre Directory January 2004*”, *JHD Advisors Pty Ltd, 2000- 2002*

<sup>2</sup> *ibid.*

<sup>3</sup> *ibid.*

<sup>4</sup> *ibid.*

independently owned retail businesses and shopping centre owners and resolution of these disputes is often managed by a range of mandated ADR measures (compulsory mediation for example) or by application to the specialist state or territory based tribunal in the first instance. The Shopping Centre Council of Australia ("SCCA") which represents the interests of shopping centre owners and managers throughout Australia recently highlighted the difficulties imposed by the plethora of legislation in this area of business activity and observed that "despite the general trend over the last decade reducing the amount of government regulation, retail tenancy regulation is one area where the amount of regulation has increased exponentially over the same period."<sup>5</sup>

Although most state and territory retail lease legislation have incorporated provisions dealing with mandatory disclosure requirements, minimum lease terms, notices to be given in respect of lease renewals, rent review protocols, requirements on assignment of the lease, compensation to tenants during relocation and payment of shopping centre contribution charges, the complexities of the disputes, the constant review of legislation and inconsistencies across state boundaries have imposed (in the opinion of the SCCA) "unnecessary administrative costs on our members who own centres in a number of states, as well as on retailers who operate nationally".<sup>6</sup>

The three most populous states in Australia are found on the eastern seaboard. In terms of shopping centre distribution, population density and capital cities, New South Wales (Sydney), Victoria (Melbourne) and Queensland (Brisbane) are the major contributors to the growth of litigation in the shopping centre sector.

For the purposes of this paper however, the cases chosen for analysis will be discussed in the context of the *Retail Leases Act 1994*, the current legislation regulating the relationship between landlords ("lessor") and tenants ("lessee") in New South Wales.

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<sup>5</sup> *ibid.*

<sup>6</sup> "Retail Tenancy Legislation", Issues and Advocacy, Shopping Centre Council of Australia.

## **RETAIL LEASES ACT 1994**

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Retail leases in New South Wales have been regulated for the last sixteen years by the *Retail Leases Act 1994* ("the Act"). Since the introduction of the Act, legislators have been under considerable pressure from the small business lobby to strengthen the consumer protection afforded to the smaller tenancies in shopping centres. Substantial changes were made to the Act with the introduction of the *Retail Leases Amendment Act 2005* which came into effect on 1 January 2006. Retail shop leases and agreements for lease of retail shops of less than 1,000 square metres are governed by the Act and the definition of a "retail shop" in s3 of the Act has been expanded to include businesses that are 'proposed to be used' for one or more of the prescribed purposes in Schedule 1.

**"retail shop"** means premises that:

- (a) are used, or proposed to be used, wholly or predominantly for the carrying on of one or more of the businesses prescribed for the purposes of this paragraph (whether or not in a retail shopping centre), or
- (b) are used, or proposed to be used, for the carrying on of any business (whether or not a business prescribed for the purposes of paragraph (a)) in a retail shopping centre.

Shops that have a 'lettable area' of more than 1000 sq m are still excluded (see s5 for this and other exclusions) but 'lettable area' is now clarified to exclude:

- (a) car parking spaces, or
- (b) storage areas not attached to the retail shop premises where the business of the shop is or is to be carried on.

### **Short-term leases – Section 6A**

s6A modifies the former position where short term leases with a 'holding over' clause were excluded from the operation of the Act. The Act now applies to a tenancy comprised of successive short-term leases whose total

terms exceed 12 months, unless a waiver of the right to a five year lease term is given by the tenant, known as a Section 16 certificate.

### **Minimum five year term – Sections 16 and 21A**

The Act provides that a retail shop lease is to be for a minimum term of five years. A tenant can agree in writing to a shorter term by having his or her lawyer or licensed conveyancer sign a Section 16 certificate, provided such certificate is given to the landlord within the first six months of the lease.

### **Retail tenancy guide – Section 9**

Section 9 has been expanded. As well as a copy of the draft lease, landlords are required to give a copy of a retail tenancy guide, developed by the NSW Government, to any prospective tenant as soon as negotiations begin.

### **Disclosure statements – Schedule 2 and 2A, Sections 11 and 11A**

Changes have been made to the disclosure statements exchanged between the tenant and the landlord prior to entering into the lease, and the disclosure statement that applies when a lease is assigned to another person.

Additions to the Lessor's Disclosure Statement, which must be given to the tenant at least seven days before the lease is signed, are:

- Details of any current legal proceedings in relation to the lawful use of the premises/centre
- The right of tenants to a five year lease must be made clear

For shopping centres, landlords have to disclose:

- the expiry date of the leases or major tenants
- the intended future mix of outlets in retail shopping centres
- further detail of information relating to administration and cleaning costs
- whether they are able to assure the tenant that the current tenancy mix in the centre will not be altered by introducing a competitor to the tenant during the course of the lease.

and to the extent where it has been collected, provide:

- the annual sales of the centre
- traffic count for the centre
- the annual turnover for specialty shops in the centre

### **Outgoings estimates and statements – Section 3, 27, 28 and 28A**

The definition of outgoings now makes clear that such expenses are to be directly and reasonably attributable to the operation, maintenance, and repair of the building.

In shopping centres, landlords are required to provide a breakdown of contribution towards the administration costs of running the centre and other fees paid to the management company, and further information on cleaning costs.

### **Costs before fit-out – Section 13**

The tenant does not have to pay more than the amount agreed with the landlord for work to be carried out by the landlord pre-fit-out.

### **Fits-Outs – Section 13A**

If the landlord of premises in a retail shopping centre requires a particular standard of fit-outs to be carried out by the tenant, the lease or disclosure statement must contain a tenancy fit-out statement that contains relevant information.

### **Disturbance – Section 34**

A lease may provide that the landlord is excluded from liability to pay compensation for a disturbance to a tenancy, provided the landlord gave a statement to the tenant before the lease was entered into.

### **Relocation – Section 34A**

A tenant is entitled to be paid reasonable fit-out costs and legal costs in connection with relocation.

### **Negotiations for renewal or extension of retail shop leases – Section 44A**

Landlords cannot publicly advertise the availability of retail premises during the term of an existing lease, unless the landlord complies with specific obligations.

### **Market Rent Review – Sections 3, 19, 31, 32, 32A, 72AB and 85**

Where a lease contains an option to renew at current market rent, the Act provides a process for a tenant to request, in writing, a determination of rent up to six months before the lease finishes. Where a tenant seeks this early determination of the rent, the tenant has 21 days to exercise the option after the tenant has been notified of the rent. If necessary, the term of the lease is to be extended until the end of the 21-day period.

### **Misleading or Deceptive Conduct**

Prior to the introduction of the 2005 Amendment Act the “injured party” was entitled to reasonable compensation for damage suffered as a result of a false or misleading statement or representation *with knowledge that it was false or misleading*.

The right to compensation under s10 of the Act was expressed in the following terms:

*(1) A party to a retail shop lease is liable to pay another party to the lease ("the injured party") reasonable compensation for damage suffered by the injured party that is attributable to the injured party's entering into the lease as a result of a false or misleading statement or representation made by the party, or any person acting under the party's authority, with knowledge that it was false or misleading.*

Amendments to the Act which commenced in January 2006 have retained s10 but added in Part 7A Division 2 of the Act a prohibition under s62D

“misleading or deceptive conduct in connection with retail leases” and a “right to compensation” by the injured party who suffers loss or damage. The new provisions are expressed in the following terms:

**62D Misleading or deceptive conduct in connection with retail leases**

*A party to a retail shop lease must not, in connection with the lease, engage in conduct that is misleading or deceptive to another party to the lease or that is likely to mislead or deceive another party to the lease.*

**62E Right to compensation**

*A party or former party to a retail shop lease who suffers loss or damage by reason of misleading or deceptive conduct of another party may recover the amount of the loss or damage by lodging a claim against the other party under section 71.*

The new provisions enable the Administrative Decisions Tribunal (“ADT”) to effectively deal with claims in the nature of a s52 *Trade Practices Act* breach for misleading or deceptive conduct. Whilst s10 of the Act to be effective required the injured party to prove that the statement or representation was known to be false or misleading, there is no such qualification in s62D and the conduct complained of is not restricted to the circumstances that existed when the injured party entered into the lease (as it is in Section 10). The monetary limit of the Tribunal’s jurisdiction has been increased to \$400,000 to deal with claims which may arise from unconscionable conduct (s62B) or misleading or deceptive conduct (s62C-s62E).

**Retail Lease Bond Scheme**

Part 2A creates and regulates this new obligation to lodge cash security bonds with the Director General of the Department of State and Regional Development. The whole process of collection and repayment has been subcontracted out to the Rental Bond Board.

Landlords and tenants are still free to choose not to have a cash bond as a condition of a lease, and a landlord cannot reasonably refuse a tenant's choice to use a bank guarantee or some other form of security.

## **THE LITIGATION PATHWAY**

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Mediation as defined in Sections 67 and 68 of the Act is an integral part of the dispute resolution mechanism for the early determination of disputes. Section 68 in particular is unequivocal in directing parties to seek a mediated resolution of the dispute before proceedings are commenced in any court, and to this effect parties are required to obtain a certificate from the Registrar noting that mediation has failed, before commencing proceedings.

The term "mediation" is intended to encompass other appropriate forms of ADR under the definition provided by s67.

### **67 The nature of mediation**

*(1) In this Division:*

*"mediation" is not limited to formal mediation procedures and includes the following:*

- (a) preliminary assistance in dispute resolution, such as the giving of advice designed to ensure that the parties are fully aware of their rights and obligations and that there is full and open communication between the parties concerning the dispute,*
- (b) other appropriate forms of alternative dispute resolution.*

### **68 Disputes and other matters must be submitted to mediation before proceedings can be taken**

*(1) A retail tenancy dispute or other dispute or matter referred to in section 65 (1) (a1) may not be the subject of proceedings before any court unless and until the Registrar has certified in writing that mediation under this*

*Part has failed to resolve the dispute or matter or the court is otherwise satisfied that mediation under this Part is unlikely to resolve the dispute or matter.*

- (2) The Registrar must certify that mediation under this Part has failed to resolve a retail tenancy dispute or other dispute or matter referred to in section 65 (1) (a1) if the Registrar is satisfied that any one or more of the parties to the dispute or matter has refused to take part in or has withdrawn from mediation of the dispute or matter.*
- (3) This section does not apply to proceedings before a court for an order in the nature of an injunction.*
- (4) This section does not operate to affect the validity of any decision made by a court.*

If 'mediation' is unsuccessful in resolving the issues the matter will proceed to a hearing before an ADT member or panel or the Supreme Court of NSW (if appropriate). When the principal issue to be decided is attributable to a claim for misleading or deceptive conduct the applicant may attempt to commence the claim in the Federal Court of Australia on the basis that compensation or other orders being sought relate to a breach of s52 of the *Trade Practices Act 1974* (Federal Legislation).

Ultimately, the judgements of the Tribunal or superior courts will reflect the need to apply the statutory provisions of the Act in conjunction with common law principles that stem from contract law, equity or tort law. As a retail lease is fundamentally a contract of covenants between lessor and lessee, it is hardly surprising that the law of contract often plays a decisive role in resolving issues that relate to the existence and terms of the retail lease including the giving of notices in respect of rent reviews or options to renew.

## **LITIGATION ISSUES IN RECENT CASES**

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### **The Randi Wixs Case**

*Randi Wixs Pty Limited v Pokana Pty Limited (No. 2) [2003] NSWADT 4 (10 January 2003)*

The issues disclosed in the proceedings before the ADT were numerous and included the following:

- Whether the purported exercise of an option to renew the lease for a further term of five years was validly exercised.
- Whether the status of the lease excluded the lessee from the benefit of s8 of the Act after the term of the lease had expired and the lessor had validly served a Notice to Quit.
- Whether the exchange of letters between the respective parties solicitors during negotiations over the possible renewal of the lease gave rise to the creation of a new lease contract between the parties.
- Whether the lessee in remaining in possession or paying rent in accordance with the terms of a new lease as negotiated by the parties, could be said to have “entered into” a lease in accordance with the provisions of s8 of the Act.

The facts of this case are not unduly complicated. The lessee, Randi Wixs, operated a restaurant in premises owned by the lessor in Avoca Street, Randwick, a Sydney suburb. The lessee claimed to occupy the premises under a retail lease within the meaning of “retail lease” as defined in the *Retail Leases Act 1994* pursuant to a lease that commenced on 7 October 1986 and terminated on 6 October 1996 (“the First Lease”) and subject to a further five year option of renewal. That option was exercised and the lessor leased the premises to the lessee for a further term of five years commencing 7 October 1996 and terminating 6 October 2001 (“the Second Lease”) together with an option to renew for a further term of five years. The decision by ADT judicial member Molloy continued thus:

“Certain difficulties arose between the parties. There was a claim by the Respondent for reimbursement of moneys expended for fire safety, there was

dispute relating to the exercise or non-exercise of the option for renewal, various negotiations took place and under cover of letter 29th January 2001 the Solicitors for the Respondent submitted to the Solicitors for the Applicant a Lease document.

Pausing at this point, it is conceded by counsel for the Applicant that the notice purporting to be a Notice of Exercise of Option was in fact not effective to exercise the option such that in reality the option was not exercised. Absent other extenuating circumstances the law in that case is absolutely clear: a lessee holding over under an expired Lease is not entitled to the benefit of Retail Leases Act Section 8.

In other words, the mere fact that a Lessee remains in occupation of the demised premises holding over under an expired Lease does not create a statutory Lease - see *Trustees Limited v Ergun* [2000] NSWSC 872. I have no difficulty in accepting that Judgment as a correct statement of the law. Were it otherwise then leases would continue on forever because all a Lessee would have to do would be to stay in occupation after the expiry of the lease and thereby create a further lease term of five years under the Act.

The question is: Are there other circumstances in this particular matter which negative or outflank the *Ergun* principle such that there is created in favour of this Applicant in all the circumstances a statutory lease? The Applicant contends that there are such circumstances.”

As noted by the Tribunal, the second lease expired on 6 October 2001 without there being in effect an exercise of the Notice of Exercise of Option. The Lease became a tenancy on a month to month basis thereafter with the lessor entitled to serve a Notice to Quit on one month's notice provided there were no statutory reasons or common law grounds which would preclude a lessor from taking such action.

The lessor in fact issued an effective Notice to Quit on 6 October 2001 and “it was conceded by Counsel for the Applicant [lessee] that the Notice to Quit

was a valid notice such that as from 7 December 2001, absent any other circumstance, the Applicant remaining in occupation was in fact in occupation as a trespasser”.

The lessee, however, maintained that there were certain matters which occurred after 7 December 2001 which, under s8 of the *Retail Leases Act*, would entitle the lessee to remain in possession of the premises as a lessee pursuant to the Act. Section 8 of the Act provides as follows:

**8 When the lease is entered into**

- (1) For the purposes of this Act, a retail shop lease is considered to have been entered into when a person enters into possession of the retail shop as lessee under the lease or begins to pay rent as lessee under the lease (whichever happens first).*
  
- (2) However, if both parties execute the lease before the lessee enters into possession under the lease or begins to pay rent under the lease, the lease is considered to have been entered into as soon as both parties have executed the lease.*

In the context of the provisions of s8 of the Act the decision of the ADT records the following factual circumstances that occurred after 7 December 2001:

“By letter dated 28th October 2001 the solicitors for the Respondent asserted that the Second Lease had expired on 6th October 2001, that the option had not been exercised and that the Notice to Quit had been properly served (and was effectively valid). The letter went on to indicate, on a "Without Prejudice" basis, that the Respondent was prepared to enter into a further lease upon certain terms. Those terms were:

- (a) All amounts outstanding under the Second Lease were to be paid 'immediately', including outstanding rent and water usage, stamp duty, "legal costs incurred in connection with the fault" (\$9,892.61);
- (b) A cash bond or bank guarantee in an amount equal to six months rent was to be provided; and
- (c) The legal costs of preparing the further lease to be paid prior to commencement.

The solicitors for the Applicant replied on 5th December 2001, also marked "Without Prejudice", stating that the Applicant would accept the terms of the 28 November 2001 letter:

*"provided that the following conditions be incorporated:*

- 1. There be an additional option period of five (5) years so the lease will be for five (5) years with a five (5) year option;*
- 2. The Bank Guarantee be for three (3) months in lieu of six (6) months;*
- 3. Your costs be paid by Mr Ostrovsky over a period of four (4) months."*

The letter went on to indicate, perhaps optimistically having regard to the lengthy litigation between the parties, that:

*"Mr Ostrovsky has a genuine desire to resolve all outstanding matters as between himself and his landlord and commence the new year on a non-contentious and fresh basis."*

The Respondent's solicitors replied 14th December 2001:

*"Our client accepts the conditions set out in your (letter) of 15th December 2001. We will contact you shortly in relation to the new lease."*

By letter dated 29th January 2002, the Lessor's Solicitors submitted a lease "subject to the final approval of the document by (the Lessor)". This letter required the Lessee to pay stamp duty, the fees of the Lessor's solicitors in connection with the lease, the fees of the Lessor's solicitors with respect to

the previous default and a sum of \$4,455.00 in relation to the fire control work undertaken on the premises. There were some other requirements which are unremarkable but it is not in issue that the lease as submitted was different in its terms to the Second Lease.

The Applicant submits that by the three letters 28th November, 5th December and 14th December 2001, there was created a contract whereby the parties agreed to enter into a lease, alternatively in fact entered into a lease, within the terms of Section 8, such lease being a bare lease, alternatively, a lease within the general terms of the Second Lease subject to the provisions as agreed in the three letters. The Respondent on the other hand submits that there is no lease created by those letters and the Applicant's case fails because of what were described as 'textual difficulties'."

Following these negotiations, the lessee commenced to pay rent from January 2002 at an increased monthly rental of \$4,904.80, such sum being an increase over the previous monthly rental of \$4,333.00, as expressed in the Second Lease. Negotiations over the Third Lease broke down and in May 2002 the applicant sought relief, declarations and consequential orders from the Tribunal, the primary issue being "*whether or not there is in fact at law a lease between the parties and, if so, the terms of that lease.*"

The Tribunal Member found the following:

"In my opinion, the terms of the letters 28th October 2001, 5th December 2001 and 14th December 2001, coupled with the payment of rent at the increased rate commencing January 2002, constituted a commercial agreement between the parties to enter into a formal lease in the terms of the Second Lease subject to the variations as negotiated and specified in those three letters.

I am of this opinion for the following reasons:

- (a) The lawyers for the parties must have meant what they wrote in those three letters. They would not have been framing their letters in such a fashion had they not intended, and the parties not intended, that they be bound by the content of their communications. Otherwise, if they are not intended to mean something, why write the letters?
- (b) Secondly, the terms of the first letter 28th November 2001 make it absolutely plain that the Respondent "is prepared to enter into a further lease on the terms set out in the option provision". Those words in my opinion make it plain that the terms of the Second Lease are the terms that are to apply to the further lease which was effectively accepted by the next two letters. There was not the slightest suggestion in any of the correspondence that the terms of the further lease would be anything other than those of the Second Lease. The terms of the lease as ultimately submitted on 29th January 2002 ("IG11") are not the terms of the Second Lease consistent with the terms set out in the option provision of the Second Lease. It was not suggested that Clause 3.2 of the Second Lease, or any other clause of that Lease, entitled the Respondent to vary the terms of any further lease entered into pursuant to the granted option and it therefore cannot follow that any further lease offered in the Respondent's Solicitor's letter dated 28th November 2001 should contain any different terms.
- (c) In my view the terms of the Respondent's Solicitor's letter 29th January 2002 are post agreement and cannot impose additional conditions upon the grant of a formal lease save as otherwise implied by the factual situation. For example, the stamp duty in the letter 28th November 2001 is stated as being \$948.30 yet the stamp duty in the letter 29th January 2002 is \$1,104.95.

- (d) It will be remembered that in the meantime the parties had in fact agreed to an additional amount of rent such that any formal lease would have to reflect that subsequent agreement and as a consequence additional stamp duty would be payable. I would have no difficulty in finding that as a result of the re-negotiated increased rent then the parties impliedly agreed that the Applicant would pay additional stamp duty on the subsequently entered into formal lease.
- (e) Although it is true that as at 7th December 2001 the Applicant was in occupation as a trespasser, the Notice to Quit being valid, in my opinion the parties one week later (14th December 2001) agreed to enter into a Lease in accordance with the terms of the three letters. At that point of time the Respondent must have been aware of the status of the Applicant's occupation (although the Respondent's agent seemed to think that the Applicant was holding over) and in any event the status has been conceded as being that of a trespasser, in my view notionally, or in fact, the Respondent permitted the Applicant to 'enter into possession ... as lessee' under the agreement between the parties for the purposes of Section 8, alternatively permitted and accepted rent to be paid by the Applicant pursuant to that agreement.

In my view in the peculiar circumstances of this case there is no requirement for the Applicant to actually vacate the premises to artificially require it to 'enter into possession' by some form of re-entry. In my opinion the correspondence and the payment of rent, when viewed correctly, permits Section 8 to be so satisfied. This Division of this Tribunal is a Division which deals with the commercial reality of the leasing of retail shops. Commercial reality does not require the artificiality of a lessee vacating demised premises and re-entering in order to satisfy Section 8. Such artificiality would put a lessee into an untenable commercial position requiring it to properly vacate, remove its fixtures and

fittings and so on and then re-enter and re-install its fixtures and fittings and so on and commercial reality militates against such a conclusion. That was clearly not the intention of the parties, could not reasonably be thought to be their intention and in any event it is plain that in January 2002 the Respondent demanded and the Applicant agreed to pay rent at an increased rate.

Having regard to the above findings, in my opinion, as at 14th December 2001 the parties had agreed to enter into a new lease upon the same terms as the Second Lease (Exhibits "IG2" and "IG3") subject to the following alterations:

- (i) Date of commencement: 14th December 2001
- (ii) Term: 5 years commencing 14th December 2001 and terminating 13th December 2006; with an option for 5 years commencing 14th December 2006 and ending 13th December 2011.
- (iii) Basic rent and review dates: In accordance with this Judgment and varied consistent with the date of commencement being 14th December 2001.
- (iv) The Lease to include a clause requiring the Applicant to provide a Banker's Guarantee for three months' rent. (I note that this is a requirement in addition to the personal guarantee of Mr Ostrovsky, Item 11)."

In retrospect, the Tribunal findings in the *Randi Wixs* case illustrate the inherent legal risk for the lessor in conducting negotiations through an exchange of letters (in these circumstances) without a preliminary legal agreement between the parties that would preclude either party from asserting that a lease agreement had been reached until both parties had executed a Retail Shop Lease in the standard form provided by the Law Society.

## **The Skiwing Cases**

*Skiwing Pty Ltd v Trust Company of Australia Ltd (No. 3) [2004] NSWADT 94  
(and six related cases cited below)*

The litigation between the parties relates to a number of matters that came before the Administrative Decisions Tribunal from 2003-2005 before reaching the NSW Court of Appeal in 2006 on a jurisdictional issue.

The discussion in this part of the litigation focuses on the issues surrounding the grant of a new lease.

The Respondent Lessee, Skiwing leased from Trust Company of Australia Limited, custodian of the responsible entity of the Stockland Trust ("Stockland"), Café Tiffany's in the Imperial Arcade although the Imperial Arcade is no longer owned by Stockland.

Café Tiffany's has been operating in the Imperial Arcade since 1965, and the current proprietor, Mr Stojonkovski has been working there since 1985. The café occupies an area of approximately 150 square metres and has windows overlooking the Pitt Street Mall.

Skiwing commenced negotiations with Stockland in 1999 to be granted a new lease of the café from May 2000 which included the construction of a balcony above the roofline overlooking the Pitt Street Mall. The Agreement placed the responsibility for obtaining Council consent for the balcony with Skiwing.

The difficulty for Stockland was that it had neither finally agreed to build a balcony if approval was granted nor agreed the terms upon which it extended the Skiwing lease beyond the delineated premises to incorporate the new area.

In September 1999 a disclosure statement was issued by Stockland stating that "No significant physical changes or development are planned for the Centre or surrounding roads by the lessor at this time....Whilst no

significant changes are envisaged at the time of this statement which would significantly affect the business of the lessee, the lessor reserves the right to change the tenancy mix of the centre during the term of the subject Lease and in the future.

The tenant's disclosure statement of 24 September 1999 stated the following: "The Lessor may sometimes do things (or delay doing things) that may have a temporary or permanent adverse effect on the Lessee's business (such as tenancy mix changes, carrying out centre improvements, alternation, or maintenance works instigating promotional activity or casual leasing etc) and the Lessor will not be required to compensate or give notice to the Lessee unless required to do so by Lease of Retail Leases Legislation." That statement was signed at the time when the 1999 renovation work was underway.

On 23 October 2001, following plans by Stockland to create a two level shop front into the mall connecting to Castlereagh Street, Stockland offered Skiwing a new lease in the standard lease proposal ("the first relocation notice"). The tenant's solicitors pointed out fundamental deficiencies in the letter, that it did purport to be a relocation notice and it could not be a relocation notice under the lease and the Act. Stockland eventually agreed that the notice was invalid and eventually issued a further two relocation notices which were also contested by Skiwing. Skiwing took its issues with the lessor to the ADT.

The Tribunal found that all relocation notices were invalid, neither complying with the lease nor the Act. In particular the second and third notices were given to secure a preferred tenant in a prime location within the arcade in similar factual circumstances that happened in *Eddie Azzi Australian Pty Limited v Citadin Pty Limited* [2001] NSWADT 79. Neither was a genuine proposal for refurbishment redevelopment or extension. Attempts were made to use the rights under the Act to replace an existing tenant with a preferred major tenant who was believed to be more likely to attract

customers to the mall. The premises could not be regarded as alternative premises.

The base rent was different, for example, in the second relocation notice it was \$85,000 where as the base rent for the alternative premises under the lease negotiated in 2001 was \$25,000. An attempt in the third relocation notice was geared around leaving the rent open in the disclosure statement stating it was the same as under the existing lease (“or adjusted to take into account of the differences in the commercial values of the premises....Determined independently in accordance with the Act”). This was flawed as there was no process under the Act for independent determination.

Stockland’s actions seriously disrupted Skiwing’s business and the resources of its management. It constituted a breach of the agreement to obtain consent to develop the balcony and caused it to engage in a major legal dispute.

The Tribunal concluded that Stockland was in breach because of the relocation notices it issued and its subsequent advice that it would not consent to a balcony. This was a repudiation of its arrangement with Skiwing to proceed once Council’s approval has been obtained. In turn, Skiwing lost its ability to expand its trading area including the ability to amend its liquor licence for a more valuable licence.

Ultimately, Skiwing was successful in obtaining an award for damages in respect of the Disturbance of Trading Claim (\$269,628), the Balcony Claim (\$53,000) and costs.

Skiwing initiated further claims in the Tribunal against Stockland seeking damages for misrepresentation under s52 of the Trade Practices Act 1974 and unconscionable conduct but Stockland appealed successfully to the NSW Court of Appeal against the Tribunal’s Appeal Panel decision that found

that the Tribunal had the jurisdiction to hear a claim for breach of s52 of the Trade Practices Act.

The Skiwing litigation (currently) can be found at the following citations:

1. *Skiwing Pty Ltd v Trust Company of Australia Ltd [2003] NSWADT 190*
2. *Skiwing Pty Ltd v Trust Company of Australia (No. 2) [2003] NSWADT 243*
3. *Skiwing Pty Ltd v Trust Company of Australia Ltd (No. 3) [2004] NSWADT 94*
4. *Skiwing Pty Ltd v Trust Company of Australia (No. 4) [2004] NSWADT 162*
5. *Skiwing Pty Ltd v Trust Company of Australia Ltd [2004] 2000 NSWADT 169*
6. *Skiwing Pty Ltd v Trust Company of Australia Ltd [2005] NSWADTAP 10*
7. *Trust Company of Australia Limited (trading as Stockland Property Management) v Skiwing Limited (trading as Café Tiffany's) [2006] NSWCA185*

### **The Cacace Case**

*Cacace v Bayside Operations Pty Limited [2006] NSWSC 572 (7 June 2006)*  
*[ interlocutory proceedings before the Supreme Court of NSW ]*

The Plaintiffs, Gregory and Natalie Cacace, operate a Cafeteria known as Crema Espresso Bar in a hotel now known as Rydges Port Macquarie owned by the Defendant, Bayside Operations Pty Limited. The Cafeteria operated under a management agreement that commenced on 1 July 2003 for a term of 5 years with an option to renew for a further period of 3 years.

The hotel also operated a restaurant through which the Cacace staff passed in accessing the hotel kitchen and other parts of the hotel premises for the purposes of operating the Cafeteria. When the Cacaces' entitlement to pass through the hotel restaurant was barred on 22 July 2005, following a

dispute, the Cacaces commenced proceedings under s68 of the *Retail Leases Act* seeking both a declaration that the management agreement was a retail shop lease, and an injunction, restraining Bayside from preventing the Cafeteria from carrying on its business via the hotel restaurant, hotel kitchen, room service area and hotel lobby and lifts and staff toilets. In the alternative, the Cacaces sought relief against forfeiture.

On 29 July 2005, interlocutory orders were made by consent permitting the Cacaces to carry on their business as they did prior to the dispute. The parties then participated in a mediation at Port Macquarie on 9 August 2005. A document entitled “Heads of Agreement” was prepared and executed by the parties.

As a result of a cross-claim filed by the Defendant, Bayside claimed an order for specific performance in relation to the “Heads of Agreement” and an order varying the interlocutory orders made on 29 July 2005. The Cacaces denied that the Heads of Agreement arising from the mediation was a binding and enforceable agreement.

#### Issues for Determination

- (1) Did the Heads of Agreement constitute a binding agreement for compromise;
- (2) if so, does that agreement remain enforceable, or has it been abandoned, or has a condition precedent failed, or would performance of it be illegal, or has it been avoided for misrepresentation
- (3) if the agreement does remain enforceable, should it be specifically performed having regard to the question of Bayside's readiness, willingness and ability to perform its own obligations under the Heads of Agreement, and to the discretion to decline specific performance for any of the reasons already mentioned;
- (4) if it were concluded that the Heads of Agreement should for any reason not be specifically enforced, should the interlocutory orders of 29 July 2005 be varied as Bayside proposes.

The Court discussed the question of whether the Heads of Agreement represented a binding contract in the context of the 3 classes of concluded negotiations identified in *Masters v Cameron (1954) 91 CLR 353* and the 4th class of concluded agreements identified in *GR Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd (1986) 40 NSWLR 622*.

The Heads of Agreement was expressed in the following terms:

1. The company will pay to Cacace the sum of \$18,750 on exchange of Agreements incorporating these Heads of Agreement which sum is on account of costs of the proceedings, the Cacace claim for contribution to the fitout of the kitchen and any claim for reimbursement of loss of profit associated with the Company's exclusion of Cacace from the premises from 22 July 2005 until 29 July 2005.
2. As from the date of exchange of the Agreement the injunction consented to on 29 July 2005 shall be dissolved and the proceedings shall be discontinued on the basis that each party shall pay their own costs.
3. As from the date of the Agreement the parties agree as follows:
  - a. Cacace shall not access the hotel premises outside the "designated area" as defined by the Management Agreement other than:
    - (i) the loading dock via the staff access for the purpose of gaining access to storage area to be constructed by the Company in the dock area (which storage area will be lockable and of about 6sqm in area and with access to power) and to obtain ice.
    - (ii) staff toilets.
    - (iii) via front lobby for access to lifts for room service.
4. Cacace shall attend to the installation of suitable refrigeration in the designated area at their own cost.

5. The company will use its best endeavours to ensure Crema's trading details are included in the hotel room compendium.
  
6. The company will ensure that Cacace is provided with adequate numbers of room service trays, plate covers and a trolley (which will be stored in the baggage storage area).

### Judicial Outcomes

His Honour found that the parties “did not in fact intend to be bound until, the proposed storage area having been constructed, the formal agreement was prepared and exchanged.” His Honour concluded “the Heads of Agreement were within class three of *Masters v Cameron*, and there was no binding agreement made at the end of the mediation.”

The four classes of contract discussed under the *Masters v Cameron* principles are summarised thus:

- (1) the first class of contract - may be one in which the parties have reached finality in arranging all the terms of their bargain and intend to be immediately bound to the performance of those terms, but at the same time propose to have the terms restated in a form which will be fuller or more precise but not different in effect.
  
- (2) the second class - may be a case in which the parties have completely agreed upon all the terms of their bargain and intend no departure from or addition to that to which their agreed terms express or implied, but nevertheless have made performance of one or more of the terms conditional upon the execution of a formal document.
  
- (3) the third class - may be one in which the intention of the parties is not to make a concluded bargain at all.
  
- (4) the fourth class - may be one in which the parties were content to be bound immediately and exclusively by the terms which they had agreed

upon, whilst expecting to make a further contract in substitution for the contract containing, by concept, additional terms.

The Court directed that the interlocutory orders are to remain in place until the final hearing and determination of the Cacaces' claim, unless earlier varied.

### **The Helou Case**

*Helou ors v Bong Bong Pty Limited anor trading as Regional Retail Properties [2006] NSWADT 128 (1 May 2006)*

On 25 June 2004, the Respondent lessor purchased a shopping centre at Bowral, NSW, known as Gibraltar Square with a number of tenancies including a monthly tenancy to Highlands Fresh Pty Ltd ("Highlands Fresh") of Shops 2, 3 and 4 of Gibraltar Square ("the Premises") which are the subject of this case. The permitted use of the Premises under the Highlands Fresh lease was 'retail sale of fruit and vegetables'. Highlands Fresh carried on business under the name of 'Bowral's Fresh Fruit World'.

The registered lease to Highlands Fresh from the previous owners of the shopping centre had expired on 5 October 2003 but continued as a monthly tenancy at a rental of \$5,830.00 when the new operators of the business (Helou & Ors) purchased the business and took possession of the shops on 18 September 2004.

The Lessor held negotiations with the new operators of the business which confirmed:

- (a) the continuance of the monthly rental (\$5830);
- (b) the lessor's intention to enlarge the shopping centre through a DA already lodged with the Council;
- (c) the necessity for the lessees to vacate the Premises during the construction period

(d) grant of a new lease subject to DA approval

After the DA was approved on 25 November 2004, the parties resumed negotiations over a new lease. On 22 February 2005, a five page letter of that date was delivered to the Lessees by the Lessor's agent. The letter formally set out terms of an agreement for the future lease and asked for a "security deposit" of \$5,000 to be "credited to your rental account".

The Lessor's letter of 22 February 2005 contained two clauses designed to defer the creation of legal obligations between the parties until formal lease documentation had been prepared and signed.

The letter was in the following terms:

*"Acceptance of this offer by the lessor will not in any circumstances create a legally enforceable lease between the parties. The lease will be prepared by the lessor's Solicitors, incorporating the above terms and conditions and no agreement will be legally enforceable unless acceptable and executed by both parties."*

*"Occupation of the premises will not be granted until the lease documentation has been completed to the satisfaction of the lessor's solicitors, provision of bank guarantee, public risk insurance and all fees paid by the lessees."*

On 8 March 2005 at a meeting between the parties, the lessee signed the letter of 22 February 2005 after an amendment was initialled by the lessor. The lessee also handed to the Lessor the security deposit of \$5,000 in the form of a cheque.

By about the middle of March 2005, the lessors decided to defer plans for the redevelopment of the centre and they re-credited the lessee's rental account with \$5,000. Ultimately, the lessor served a Notice to Quit on the lessee dated 31 August 2005 on the basis that the lessee was still in possession on a monthly tenancy. The lessee filed an application with the

ADT claiming that the lessee had a lease for a term of 5 years from 8 March 2005.

The central issues in the dispute over the lease quickly became apparent:

- a) whether a new lease was granted in September 2004 when the Lessee (as the new operator of the business) took possession of the monthly tenancy held by Highlands Fresh Pty Ltd by assignment with the consent of the Lessor (see s6(1) of the Act).
- b) whether the Common Law rules imposed by *Masters v Cameron* (1954) 91 CLR 353 should prevail in circumstances where there is conflict with the legislative intention in the *Retail Leases Act*. (see s7 and s8 of the Act)
- c) whether the term of the lease should be for a period of 5 years commencing 8 March 2005.

**s7 This Act overrides leases**

*“This Act operates despite the provisions of a lease. A provision of a lease is void to the extent that the provision is inconsistent with a provision of this Act. A provision of any agreement or arrangement between the parties to a lease is void to the extent that the provision would be void if it were in the lease.”*

**s8 When the lease is entered into**

- (1) *For the purposes of this Act, a retail shop lease is considered to have been entered into when a person enters into possession of the retail shop as lessee under the lease or begins to pay rent as lessee under the lease (whichever happens first).*
- (2) *However, if both parties execute the lease before the lessee enters into possession under the lease or begins to pay rent under the lease, the lease is considered to have been entered into as soon as both parties have executed the lease.*

The Tribunal found that “on 8 March 2005 the parties attained a sufficient ‘consensus’ to attract the operation of s 8(1) of the Retail Leases Act 1994 and the Applicants notionally entered into possession of the Premises within the meaning of this subsection.” In addition to the above the Tribunal found that the commencement date of the lease was 8 March 2005 for a term of 5 years in accordance with the provisions of s16(1) of the Act. The Tribunal noted the following:

*“Firstly, a person who is already in possession of retail shop premises pursuant to a pre-existing tenancy not covered by the Act may be said notionally to ‘enter into possession... as lessee under the lease’ without vacating and re-entering the premises, once an agreement for a new lease falling within the Act is concluded.”*

*“Secondly, the commencement of a lease by virtue of entry into possession or payment of rent by the lessee may occur under s8(1) even though no formal deed or agreement of lease is ever executed, so long as the parties have reached ‘consensus’ as to the terms of the lease.”*

*“Thirdly, in order to reach this ‘consensus’, so as to give rise to the requisite ‘lease relationship’, it is not necessary that the parties reach agreement on all the terms of the right of occupation. This is an implicit consequence of the broad definition of ‘lease’ in s3, embracing ‘any agreement’, express or implied, and whether oral, in writing, or partly oral or partly in writing, ‘under which a person grants or agrees to grant to another person for value a right of occupation of premises for the purposes of the use of the premises as a retail shop’.*

### **The Bava Case**

*Bava Holdings Pty Limited V Pando Holdings Pty Limited (1998) NSW Conv R 55-862*

The matter came before Santow J in the Equity Division of the Supreme Court of New South Wales. The Plaintiff lessee (Bava) claimed to have validly

exercised an option for renewal of a lease to which the Retail Leases Act 1994 applies. The Defendant lessor (Pando) was the developer of a marina complex at Soldiers Point, Point Stephens which included a restaurant, the subject of these proceedings. Bava entered into a lease with Pando which granted a term of 12 months commencing 1 November 1996 with three options to renew at three yearly intervals. It was not disputed that the restaurant and subject lease came within the application of the *Retail Leases Act 1994*. The judgement of Santow J indicates that there were three issues to be determined:

Question 1: The rent determination

Was a rent determination requested in compliance with the Act and, if so, was a valid rent determination made?

Question 2: The option

Was the lease option validly exercised so as to give the lessee the right to a renewal of the lease (and if not, is the lessee — by reason of estoppel or otherwise — entitled to be treated as if the option was correctly exercised)?

Question 3: The valuation

If Bava is entitled to a renewal of the lease, was Mr Fagan's valuation a determination in accordance with s 31 of the Act so as to bind the parties?

His honour's judgement outlines the principal evidentiary base in the following terms:

At the time of entering into the lease agreement, the premises were not fitted out for the operation of a restaurant and were, in fact, (in Mr Butler's words), "a bare shell" (Affidavit Barry Butler sworn 27 October 1997 para7). Bava entered into possession of the premises in or around August 1996 and carried out a complete fit-out in preparation for the opening of the restaurant. This work, which included the erection of internal walls and laying of floor and wall coverings, as well as provision of kitchen plant and fittings and installation of furniture, was done at the expense of Bava and

cost (according to Bava) some \$225,000. Though that upper amount is not accepted by Pando, on the state of the evidence I am satisfied that a substantial sum was spent and quite possibly of that order.

On 8 November 1996, the restaurant, called "Deckies", opened for trading. It appears to have traded well over the Christmas period (Affidavit Kenneth Stewart sworn 5 December 1997 para14). On 27 March 1997, Mr Butler and Mr Stewart met and discussed the question of renewing the lease. According to Mr Butler, he and Mr Stewart had a conversation to the following effect:

Mr Butler (Bava): 'We intend to continue on in the Restaurant, even though it has not come up to our expectations based on the statements which you made to us. That is subject to the rent being determined.'

Mr Stewart (Pando): 'I am prepared to continue with the arrangement. I will advise you of the rental for the next period.'

(Affidavit Barry Butler sworn 27 October 1997 para10).

Mr Stewart says that he said the following to Mr Butler "The business is not being run to its full potential. Obviously the periods where most business can be obtained you are not open, like New Year's Day. Perhaps you should look towards putting on more staff during the holiday season."

(Affidavit Kenneth Stewart sworn 5 December 1997 para23)

In a letter dated 16 April 1997 to Bava (and received by Bava on or shortly after that date), Mr Stewart referred to their meeting of 27 March, said that Pando was "prepared to carry on with the lease as set out in our original agreement of 3x3x3 years" and advised that the "[r]ent for the next three years would be \$5,500 per month from 1.11.97 with the CPI adjusted annually" (Affidavit Kenneth Stewart sworn 5 December 1997 para16, Annexure D).

Bava did not reply in writing to this letter until July 1997. Mr Butler gave evidence that the reason for this delay (of some three months) was that he was in Perth at the time the letter was sent, and that, while on his return to Port Stephens he made various enquiries of local agents in an attempt to

obtain a rental estimate of his own, he had some difficulty in getting one (T, 23). In fact, it was not until July that he responded to Mr Stewart's letter. On or around 21 July 1997, Pando received a letter by facsimile rejecting the rent proposal of \$5,500 per month and stating the following:

"the area is not yet able to sustain rent in the order of your request ie \$5500/month for bare rental of a shell. At present it provides 3-4 months of reasonable clientele and 8-9 months of poor attendance. We have appraised the position and believe a fair annual rental for the premises only (ie no fittings or improvements) is . . . \$30,000 pa or \$2500/month. Please advise your acceptance or arrange for a valuer to proceed with a Market Review as per the relevant clause in the lease."

(Affidavit Barry Butler sworn 27 October 1997 para12, Annexure D).

Mr Stewart recalls that, in June 1997, prior to this communication, he and Mr Butler had a conversation about a new lease and Mr Butler said to him words to the effect "We can't afford to pay the new rent because we are not attracting the customers. The rent is too high so you will have to adjust the rent downwards". Mr Stewart claims that he responded "You previously had told me that the restaurant was going better than you anticipated. There had been a number of complaints made to me about the way in which the restaurant is run and I do not believe that it is being run to its full potential" (Affidavit Kenneth Stewart sworn 5 December 1997 para17).

Bava's suggestion of \$2,500 per month was not acceptable to Pando. Mr Stewart replied to the offer by letter on 22 July 1997, stating that that proposal "is certainly not acceptable to us and our letter dated April 16, 1997, still stands" (Affidavit Kenneth Stewart sworn 5 December 1997 para16, Annexure F). Mr Butler, on behalf of Bava, responded to this on 24 July 1997 by returning to Mr Stewart a copy of the 22 July letter with the following handwritten note at the bottom (Affidavit Barry Butler sworn 27 October 1997 para14, Annexure F):

"As advised, we are keen to continue, please arrange for a Market Review as per the Conditions of Contract"

Following receipt of this note, at around the end of July, Mr Stewart instructed a Mr Fagan, a registered valuer, to provide a valuation of the annual market rental for a new lease. At no time prior to this engagement did Mr Stewart seek Mr Butler's agreement on (or otherwise consult him as to) the appointment of Mr Fagan (Affidavit Barry Butler sworn 27 October 1997 para17). Mr Fagan, without Mr Butler's knowledge, inspected the premises on 11 August 1997 and prepared his valuation on 15 August 1997. That valuation, expressed to be made on the instruction of and for the "exclusive use of Mr Ken Stewart, for the purposes of rental appraisal" assessed the net annual rental of the premises (as at 1 November 1997) at \$61,950.

Mr Stewart wrote the following to Mr Butler on 8 August 1997 (Affidavit Kenneth Stewart sworn 5 December 1997 para16, Annexure H):

"With regard to your note on the bottom of our letter dated 22/7/97 would you please advise in writing as to your request for a market review and state that you will abide by its decision.

It would also be noted that we would share the cost 50-50."

On 18 August 1997, Mr Stewart informed Mr Butler in writing that (Affidavit Barry Butler sworn 27 October 1997 para16, Annexure H):

"We have as requested engaged a valuer for rent review at the restaurant and they have requested your returns for 1996-1997."

This letter gave the name and address of Mr Fagan and requested that the returns be sent directly to him. Mr Butler did not respond to this letter as he had, on 15 August 1997, referred the matter to his solicitors (Affidavit Barry Butler sworn 27 October 1997 para16).

Mr Stewart wrote again on 27 August 1997 requesting that Mr Butler give the matter urgent attention (Affidavit Kenneth Stewart sworn 5 December 1997 para16, Annexure I).

On 29 August 1997, solicitors for Pando wrote to Mr Butler as follows (Affidavit of Barry Butler sworn 27 October 1997 para18, Annexure I):

"We are instructed that as no option for a Lease has been sought in accordance with cl9 of the Lease, Bava Holdings Pty Ltd is required to vacate the premises on the expiration date of the Lease, namely 31 October 1997."

On 4 September 1997 Mr Butler sent a letter by facsimile to Mr Stewart as follows (Affidavit Barry Butler sworn 27 October 1997 para19, Annexure J):

"Further to discussions and correspondence we confirm our intent to exercise the option, subject to agreement to market review of rent of premises. We further understand that this review is proceeding under ..... Mr Chris Fagan of Dupont Fagan Valuers. Our Solicitors Hunt and Hunt of Newcastle have been in contact with the valuer."

Mr Butler gave evidence, which I accept, that when he wrote to Mr Stewart on 4 September 1997 stating that Bava "understand that this review is proceeding under the control by [sic] Mr Chris Fagan", he was aware that Mr Fagan had in fact already carried out an inspection and completed a report (Affidavit Barry Butler sworn 3 February 1998 para2(i)).

On 5 September 1997, Mr Stewart wrote to Mr Butler as follows:

"It is our view that the option to renew the lease has not been exercised properly and, accordingly Pando Holdings Pty Ltd are under no obligation to renew the lease.

In this regard, therefore, the determination of the rent for the next term is a matter of negotiation rather than valuation. Accordingly, we give you notice that we will not necessarily consider ourselves bound by any valuation by Chris Fagan as to rental, and if we decide to renew the lease, we will discuss the granting of a new lease and the rental, upon receipt of communication from the valuer."

Mr Butler gave evidence that he tried to contact Mr Fagan by telephone on 17 and 18 September 1997 but was unable to reach him (Affidavit Barry Butler sworn 27 October 1997 para21). Mr Butler received a copy of (part of)

Mr Fagan's valuation on 19 September 1997 (Affidavit Barry Butler sworn 27 October 1997 para22, Annexure L). This was the first occasion on which he was informed of Mr Fagan's valuation and the first time that he became aware that the valuation had taken place on 11 August 1997 (Affidavit Barry Butler sworn 27 October 1997 para22).

The parties met on 29 September 1997 at the restaurant. There was some disagreement in the affidavit evidence as to what was said at this meeting, but it seems agreed that Mr Stewart told Mr Butler that if Bava did not agree to the valuation which Mr Fagan had made, that Bava should have a second one made and that an arbitrator could then assess them. Mr Butler replied that they were not prepared to do this and suggest that they should proceed to request the President of the Real Estate Institute to appoint a valuer "as the lease requires" (his words).

On 3 October 1997 Mr Butler wrote to Mr Stewart (Affidavit of Barry Butler sworn 25 October 1997 para26, Annexure N) disputing Pando's claim that they were no longer entitled to a renewal of the lease and objecting to the valuation provided by Mr Fagan. They made another rental proposal or suggested that further negotiations take place. By letter dated 7 October 1997, Pando's solicitors advised Bava that their rent proposal was unacceptable and that rental in accordance with Mr Fagan's valuation would be required. It added further that "As the option to renew the lease has not been exercised, unless this offer is acceptable, then you are required to vacate the premises at the termination of the existing lease, namely 31 October 1997."

By letter dated 8 October 1997, Bava advised Pando's solicitors that "[a]s we have not reached agreement on the rent, we now advise that pursuant to c11.2(b) we have asked the President of the Australian institute of Valuers and Land Economists (NSW Division) Inc to appoint a valuer to decide on a rental." (Affidavit Barry Butler sworn 27 October 1997 para30, Annexure Q). (The latter, not the President of the Real Estate Institute, is the appointor under s31(d) of the Act.)

On or about 20 October 1997, Mr Stewart received a notice purporting to exercise the option to renew the lease (Affidavit Kenneth Stewart sworn 5 December 1997 para22, Annexure N). (It will become clear that that date would have been too late, if this notice were relied upon to exercise the option.) Mr Stewart gave the following affidavit evidence in relation to his receipt of this notice:

"[this was] the first occasion upon which I had received a formal notice of exercise of the option and apart from the correspondence previously referred to in this affidavit, I was not aware that the plaintiff in fact intended to remain in possession of the premises. I [sic] was always my belief that if the rent which was independently assessed for the first year of the new term of the lease was not acceptable to the plaintiff, then the plaintiff would not renew the lease and terminate its occupation of the premises." (Affidavit Kenneth Stewart sworn 5 December 1997 para22).

According to Mr Butler, however, the Defendant was aware that Bava wished to remain in possession of the premises and that the rent which was assessed for the first year of the new lease was not acceptable. I accept that, based on what had earlier transpired, Mr Stewart should have been so aware and probably was. Mr Butler gave the following evidence (Affidavit Barry Butler sworn 3 February 1998 para2(1)):

"[d]uring the whole of my discussions with Mr Stewart within the period from March 1997 to September 1997, I made it clear to Mr Stewart that the Plaintiff intended to remain on the premises, but that I would insist that the formalities of the Lease be complied with in so far as the assessment of the new rent was concerned. I made it clear to him on a number of occasions that I was aware that the Lease provided a mechanism for the rent for the new term to be properly and independently determined, and that in the event of any dispute between us as to what the rent should be, then such rent was to be determined by an independent person appointed by the President of the Real Estate Institute of NSW. At no time prior to my receiving from Mr Stewart the letter dated 5 September 1997 . . . did I have any idea that the defendant was of the opinion that the option to renew the

lease had not been properly exercised. Indeed at all times after 16 April 1997 (being the date on or about which I received from Mr Stewart the letter [in which it was stated that that Panto was prepared to carry on with the lease as set out in our original agreement of 3x3x3 years]) I was acting on the assumption that the Defendant had agreed to the Lease being renewed and that thereafter the new rent payable would be determined in accordance with the provisions of the Lease.

### The issue of the Option

In respect of the option issue [whether the option was validly exercised], his Honour's summation of the relevant law is highly instructive for practitioners facing a purported exercise of an option that is being challenged with respect to validity:

"As a general rule and traditionally, an option must be exercised in strict compliance with the requirements set out for such exercise (that is, strictly within the time and in the form stipulated, with the grantee having met any conditions precedent imposed): *Tonitto v Bassal* (1992) 28 NSWLR 564; "in the sphere of options it is a cold hard world" (*Burrell v Cameron* (SCNSW, Windeyer J, 4 April 1997, unreported). As Goulding J said in *Carradine Properties Ltd v Aslam* [1976] 1 WLR 442 at 446:

"In an option clause the requirement is that a party must strictly comply with the condition for its exercise. If the condition includes the giving of a particular notice, it seems to me that the logical first approach is to interpret the notice, looking at the words and applying legal principles to their construction, and then ask whether it complies with the strict requirements as to the exercise of the option."

More recently, however, there has been some signs of relaxation of this strict approach, though by reference primarily to ordinary principles of construction. This is more incipiently and tentatively as regards minor time infractions (for example, *Hillier v Goodfellow* [1988] Vic Conv R54-310), and the trend remains the other way (see for example, *Bressan v Squires* [1974]

2NSWLR 460; *Diakogiannis v Johnson* (1989) NSW Con R55-472). But significantly, in construing notices with some inaccuracy, obvious error or looseness of formal expression, the courts have simply asked how would the recipient, as a reasonable commercial person, be taken to have understood the intent of the notice: *Mannai Ltd v Eagle Star Association Company Ltd* [1997] 2 WLR 945. That this approach has manifested itself so far in cases dealing with a notice to terminate a lease -- so called "break clauses" -- does not alter the application of that principle to option cases. This is demonstrated by the juxtaposition, without discrimination, of those two categories in *Carradine Properties Ltd* (*supra*) at 446.

So far as the time requirements in the present case are concerned, it has already been noted that the option exercise period -- the time within which the option must be exercised so as to entitle the lessee to a new lease -- was in this case, from 30 April 1997 until 31 July 1997 (the "exercise period"). So far as the form in which the notice is to be given, the Defendant submitted (and the Plaintiff conceded) that c19.1 of the Lease Agreement, which states that the lessee was required to give "a notice" that it wanted to renew the lease, necessarily required the exercise of the option to be in writing.

At what point (if any) in the period 30 April 1997 to 31 July 1997 could Bava be said to have exercised its option to renew the lease? The first possible occasion is 27 March 1997. It has been established that Mr Butler and Mr Stewart met on 27 March 1997, at which time Mr Butler told Mr Stewart that Bava "intend to continue on in the Restaurant ... .. subject to the rent being determined" (Affidavit Barry Butler sworn 27 October 1997 para10). That indication was not, however, in writing. Moreover, it was not within the option exercise period, being before the commencement of that period. A purported exercise of an option before the exercise period is as fatal to its validity as a purported exercise after that time: *Diakogiannis v Johnson* (*supra*); *Biondi v Killington and Piccadilly Estates* [1947] 2 All ER 56. Being not in writing and also premature, even the more recent emerging trend for lesser strictness could not save it.

But what was said at the meeting may colour what followed between the parties, to the extent that later communications were ambiguous. Clearly enough it points to a determination to renew. But the ambiguous words "subject to" the rent being determined may suggest a qualification. Or it may simply be pointing to a necessary prior step laid down by c19.1(d), where s32 of the Act is inapplicable and which is by no means a qualification on that intent. Clearly enough the rent is either to be determined by agreement -- in that sense the result has to be satisfactory to both parties -- or absent their agreement as laid down by a valuer.

On 21 or 22 July 1997, however -- within the exercise period -- Bava sent a letter by facsimile to Mr Stewart, in which Mr Butler advised that Pando's previous rent proposal (made in Pando's letter of 16 April 1997 following the meeting of 27 March 1997) was unacceptable. Bava proposed a rental of \$2,500 per month and requested either acceptance of this counter-proposal or for Pando to "arrange for a valuer to proceed with a Market Review as per the relevant clause in the lease" (Affidavit Barry Butler sworn 27 October 1997 para12, Annexure D). All of that is within the contemplation of c11.2(b) of the Lease Agreement, read with item 4, and rendered applicable by c19.1(d)

Pando responded to this letter on 22 July 1997 by advising that Bava's proposal was unacceptable and that Pando's original proposal of \$5,000/month was still open. Mr Butler resumed a copy of the letter with a handwritten note at the bottom stating "As advised, we are keen to continue, please arrange for a Market Review as per the Conditions of Contract".

Can it be said that either or both of these letters, though expressed informally, constituted an effective exercise of the option? Or was the last communication really to be understood as saying, "yes we want the lease, but only if the next review result is satisfactory to us", that is to say a qualified exercise, which in law is no exercise at all. The Defendant submits that a valid exercise of an option must be "absolute and unqualified" so as to "bind [the grantor] to perform the very terms set out in the option" (Quadling

v Robinson (1976) 137 CLR 192 per Gibbs J at 200-01), and that the only "absolute and unqualified" notice received by the Defendant was that dated 16 October 1997, outside the time in which the option was required to be exercised. The words used by the lessee in correspondence with the lessor during the exercise period are said to have been insufficiently precise to constitute "absolute and unqualified" exercise of the option.

The Defendant's submission in this regard appears to me to go beyond what Gibbs J meant when using those adjectives in *Quadling*. I set them out in context below:

"It is clear that the exercise of the option, to be valid, must have been absolute and unqualified and must have bound the respondents to perform the very terms set out in the option. ... .. However, it is not always easy to determine whether the purported exercise of an option should be understood as attempting to vary the terms of the option or as intending to accept its terms without modification, notwithstanding that they may have been misdescribed, or notwithstanding that the grantee of the option may have indicated that he intends to perform the contract in a manner for which the terms of the option do not provide. Thus although a notice misstates the terms of the option which it purports to exercise, it may nevertheless amount to an unqualified and unconditional exercise of the option. ... .. On the other hand, if the grantee of an option sets out his own erroneous understanding of the option, and then purports to exercise the option as so understood, there will (speaking generally) be no effective exercise of the option.... It must of course depend upon the proper construction of the document by which the grantee purports to exercise an option whether it amounts to an absolute and unqualified acceptance of the rights and liabilities conditionally created by the option" (at 200-1).

The words "absolute and unqualified" in the context used above, relate (in my view) to whether or not the person purporting to exercise the option seeks illegitimately to vary the option in some way (for example by introducing or imposing new conditions upon the grantor). This is as opposed to simply accepting the offer which the option constitutes or satisfying the condition precedent to the contract which the option creates

(depending on whether an option is viewed as irrevocable offer or conditional contract, respectively). In stating that the exercise must be "absolute and unqualified", his Honour was not discussing whether or not the word's used were sufficiently precise to indicate a clear intention to exercise the option and renew the lease. For that reason, the decision is of limited assistance in this matter.

It could not be said that Bava, in requesting that the rent review go ahead, were seeking to vary or introduce any new conditions or otherwise vary the option agreement. What it was clearly enough saying is, we want to exercise the option and, having failed to agree a future rent, want that determined by a valuer "as per the relevant clause of the lease" -- here cl9.1(d) and cl1.2(b). It is true that Bava's letters to Pando within the exercise period of the option make reference to the fact that a rent review was to be conducted to set the rent for the new term, but this cannot be construed as an attempt to introduce any new condition into the option agreement in light of the actual provisions of the Lease Agreement thereby invoked. The parties agreed, at the time of entering into the Lease Agreement, that the rent for the new term was to be at "market rent". This is as determined upon Market Review Dates, including after six months from the commencement of the lease for the ensuing three years of the option period where the option is exercised; see item 4 and cl1.2 (to be read conformably with s31) dealing with the procedure for that review. It is not at all unusual for an option clause to provide for rent to be such as agreed by the Lessor and Lessee or, failing that, to be determined in a manner set out in the Lease. Such was the case, for example, in *Booker Industries Pty Ltd v Wilson Parking (QLD) Pty Ltd* (1982) 149 CLR 600 and *Prudential Assurance Co Ltd v Health Minders Pty Ltd* (1987) 9 NSWLR 673.

I thus conclude that the Defendant's submission on this point fails - there was no relevant qualification or condition.

Were, however, the words used by the Plaintiff sufficiently unequivocal, in the circumstances of the case, to constitute an exercise of the option? As I

have already stated, the "absolute and unqualified" requirement relates to attempts to vary the terms of an option, not to the way in which the notice of exercise is expressed. The principles relating to whether words used in purported exercise of an option indicate with sufficient certainty that the option is being exercised are found in *Prudential Assurance Co Ltd v Health Minders Pty Ltd* (supra). In that case, a notice given by lessee in the following terms:

"... .. I now give official notice that we intend to exercise our option. ... .. This option is of course subject to satisfactory terms and conditions being negotiated" was found in the first instance (by Bryson J) to constitute a valid exercise of an option to renew a lease. This finding was upheld on appeal. The Court of Appeal (Kirby P, Samuels and McHugh JJA), in determining whether or not the option was validly exercised, applied the tests as formulated by Dixon CJ in *Ballas v Theophilos (No 2)*, (1957) 98 CLR 193 and Isaacs J in *Carter v Hyde* (1923) 33 CLR 115. Dixon CJ stated that in determining whether or not an option has been validly exercised, it must be considered whether the purported exercise expressed "clearly" and "unequivocally" the fact that the exercise of the option was intended (at 196). Isaacs J stated that the question to be asked in a given circumstance is whether a reasonable recipient of a letter (purporting to exercise an option), reading it against the background of the dealings between the parties (and all the "circumstances of its receipt": per Isaacs J at 126), would have understood the sender to be exercising the option. This is just the approach adopted by the House of Lords in *Mannai Ltd* (supra) in relation to a notice to terminate a lease. Thus Lord Steyn (at 964G):

"In determining the meaning of the language of a commercial contract, and unilateral contractual notices, the law therefore generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on niceties of language. In contradistinction to this modern approach Lord Greene MR's judgment in *Hankey v Clavering* [1942] 2 KB

326 is rigid and formalistic. Nowadays one expects a notice to determine under a commercial lease to be interpreted not as a 'technical document' but in accordance with business common sense: see *Micrografix v Woking 8 Ltd* [1995] 2 EGLR 32. After all there is no reason whatever why such a document must be drafted by a lawyer. Qualitatively, the notices are of the same type as notices under charter parties and contracts of affreightment. Such notices, even if they entail the exercise of important options, are habitually drafted by commercial men rather than lawyers. It would be a disservice to commercial practice to classify such notices as technical documents and to require them to be interpreted as such. Nowadays one must substitute for the rigid rule in *Hankey v Glavering* the standard of a commercial construction.

Of significance in this case is the fact that the only documents created during the option exercise period were letters written by a lay person (that is, Mr Butler on behalf of Bava). This must be taken into consideration when deciding the intention underlying the documents and what the recipient must have understood such intention to be. In *Prudential*, where the purported option exercise was also created by a lay person, Kirby P (at 678) warned that it was "a mistake, in a letter apparently drawn by a layman, to adopt an approach of a close analysis of the terms of every word".

Such notices as were received by Pando during the exercise period must be considered "in all the circumstances of the letter's receipt". Kirby P in *Prudential* explained these words as requiring the court to consider the document "against the background of the dealings between the parties" (at 679). The opportunity for the lessee -- pursuant to s32 of the Act -- to request an "obligation-free quote" is but one such circumstance. In view of the fact that Bava had a right to obtain a rent determination and then decide not to exercise the option and proceed with a renewal of the lease, it might be argued that the words "..... we are keen to continue, please arrange for a Market Review as per the Conditions of Contract" (see Bava's note of 24 July 1997) cannot be construed as giving sufficient certainty to Bava's intention

to renew the lease, insofar as the letter may be construed as referring only to the "obligation free quote".

As against this, however, I note the amount which Bava spent -- in the order of \$225,000 or at least a very substantial amount -- in fitting out the premises. I also note the evidence given by Mr Butler (Bava) and Mr Stewart (Pando) regarding the other's knowledge of their intentions regarding the Lease Agreement. I am satisfied to accept Mr Butler's evidence that Pando was aware that Bava intended to renew the lease as against Mr Stewart's evidence that the first indication of this was only on 20 October 1997. It is hardly to be expected that Bava would engage in expenditure at that level and only remain in the premises one year.

Thus on balance, taking the above into account, I have concluded that the option was validly exercised; in particular I conclude that it was exercised within time and in a manner sufficiently conveying to Pando Bava's intention to exercise the option to renew the lease for a further term. The factors and circumstances pointing to that conclusion are:

- (i) what was said at the meeting of 27 March 1997, though before the exercise period and not in writing, demonstrates Bava's keenness to exercise the option, subject to determining the rent as indeed the lease required -- while not of itself capable of constituting an exercise it supports, or is at least consistent with, a construction of the later correspondence as conveying that intent;
- (ii) the large amount spent by the lessee, which is not consistent with an intention merely to have a one year lease;
- (iii) that the option was exercised without qualification is supported by the correspondence of 21 and 22 July 1997 forming the background to the endorsement of 24 July 1997, the latter invoking "the Market Review as per the conditions of Contract"; this correspondence should be read collectively (see *ANZ Banking Group v Widin* (1990) 26 FCR 21 at 29 by analogy to Statute of Frauds cases, cited by Young J in *Suiga Pty Ltd v Hamden Properties Pty Ltd* (SCNSW, Young J, 2 April 1997, unreported));

(iv) the correspondence reflects a sequence matching the lease terms and s31 -- first an attempt is made -- unsuccessfully as it turns out -- to agree the future rent but it is agreed it will be set by the valuer as the lease requires so invoking its rent setting mechanism.”

### **Commentary on Options for Renewal**

As demonstrated in the *Randi Wixs* case and the *Bava Holdings* case, the effective exercise of an option for renewal is of paramount importance to the commercial relationship between landlord and tenant. Ideally, the enterprising tenant (lessee) will endeavour through the operation of the business to maximise the income stream and develop the value of the goodwill over the term of the lease. The term of the lease plus the option for renewal provide the necessary mechanism for: a) the amortisation of the fit-out costs over the term of the lease (which may or may not include part or whole of the additional term created by the exercise of the renewal option); b) the development of goodwill as a saleable asset (measured by the value of the fit-out plus the growth in business over the previous tenancy), and, c) the legal ability to be able to assign the lease and sell the business with a remaining term (partly dependant on the existence of renewable options).

A lease with a short unexpired term and no guaranteed option for renewal is not an attractive proposition for a prospective purchaser of the business and future tenant. Indeed, a current tenant who has failed to effectively exercise an option for renewal is in an invidious position from a legal and financial perspective. The lessor is not obligated to offer the current lessee a new lease (at current market rent) at the end of the term if the lessee fails to effectively exercise the option for renewal. The lessor is free to offer a tenancy of the retail shop to all in sundry *after* the term of the lease has expired. In NSW, lessors are prohibited from offering the availability of the retail shop for lease *during* the term of the lease without the consent of the lessee under the provisions of s44A of the Act:

#### **44A Negotiations for renewal or extension of lease**

- (1) *A lessor of a retail shop must not, by written or broadcast advertisement, indicate the availability of the shop for lease or invite tenders or expressions of interest for tendering, during the term of the lease, unless:*
- (a) *the lessor has offered the lessee a renewal or extension of the lease under section 44 (1) (a), the offer has not been accepted and (not earlier than one month after the offer was made) the lessor by written notice informs the lessee that negotiations are concluded without result, or*
  - (b) *the lessor by written notice informs the lessee that the lessor does not propose to offer the lessee a renewal or extension of the lease and there are no arrangements to allow the lessee to remain in possession of the shop, or*
  - (c) *the lessee by written notice informs the lessor that the lessee does not wish to enter into negotiations for the renewal or extension of the lease or that the lessee wishes to withdraw from the negotiations, or*
  - (d) *the lessee has vacated or agrees in writing to vacate the shop, or*
  - (e) *the lessee consents in writing to publication of the advertisement.*
- (2) *This section does not affect the industry practice of testing the market, otherwise than by written or broadcast advertisement, in connection with the leasing of a retail shop.*
- (3) *This section does not apply to a lease of community land within the meaning of the Local Government Act 1993.*

As case histories demonstrate, even negotiations during the final months of the term of the lease can be legally dangerous for a lessor where a lessee has failed to exercise the option of renewal and the parties enter into negotiations (see *Randi Wixs* and *Bava Holdings*

cases). The following two cases [*Awad* and *Makhoul*] demonstrate in one instance the importance of strict compliance with the condition for the exercise of the option (*Awad*) and in the second instance the use of estoppel to prevent a lessee from being deprived of the benefit of an option to renew despite a defective exercise of the option for renewal (*Makhoul*). In this instance of estoppel by conduct, the general rule is that where a person by words or conduct wilfully or by negligence causes another to believe in the existence of a certain state of things, and induces that other person to act on that belief, so as to alter his own previous position, the former is precluded from denying the existence of that state of facts.

### **The Awad Case**

*Awad v Bucasia Pty Ltd [2003] NSWADT 247 (18 November 2003)*

In *Awad*, the Applicant lessee sought an order that the Respondent lessor who also owned the building grant to him a lease of three years, starting from 1 July 2003, of three shops, which included a pharmacy, and an office. The grounds for this claim were expressed to be that the lessee had validly exercised an option of renewal of the lease for a further period of three year from 30 June 2003. Alternatively, the Lessee sought an award of damages against the Lessor on account of its refusal to grant a further lease.

The original lease was signed in June 1999 for a four year term and also included the right to exercise an option to purchase.

In March 2002, the lessee was aware of the lessor's intention to sell the property and in order to protect his right to exercise the option to purchase, he lodged a caveat, but later had it withdrawn because he could not raise the finance to fund the purchase. Once the caveat was withdrawn, the building was sold to the current lessor who is the Respondent in these proceedings.

During August or September 2002, the lessor's director met the lessee at his home to discuss the lessor's proposals for development of the building. The lessee claimed that he had told the lessor of his intention to exercise his option to renew the lease for a further term of three years from 30 June 2003 but such a claim was denied by the lessor's director.

The lessee also claimed that he had a conversation with the lessor's property manager in October 2002 regarding the exercise of his option to renew the lease but the lessor's property manager said that the topic of that particular conversation was only on the location of a sign.

In November 2002, the lessor's solicitor informed the lessee by letter that the property had been sold and instructed the lessee to pay all future rent to the new lessor's property manager.

On 6 November 2002, the lessor's director had a meeting with its property manager and instructed him to advise immediately if the lessee had contacted him about the exercise of the option.

The Lessee subsequently claimed that he had sent the notice of intention by fax to the lessor's agent on 18 December and by post on or shortly after that date. However, the Lessor said in evidence that no such notice was sent or received until January 2003.

The Tribunal concluded that for the option of the renewal of the lease to be validly exercised, the notice of intention to exercise the option to renew should have been in writing and received by the lessor not less than six months before its expiry date which was on or before 31 December 2002.

The Tribunal found that the Lessee has failed to establish that he had effectively exercised his option to renew the lease by following the protocols in respect of the Notice of Exercise of the Option. The lessee's evidence of the fax transmission verification report was contradictory and the post book recording outgoing letters and costs of stamps during December in his office

was not tendered as evidence in the proceedings. The evidence before the Tribunal raised significant doubts about the credibility of the Lessee's claim to have sent the letter by post.

The Lessee also claimed that he had rung the lessor's property manager between 18 and 25 December 2002 and left a message to which he received no reply but this important event was not mentioned in his affidavit evidence.

Even though the lessee realised it was important to give written notice before the end of 2002 to effectively exercise the option, he did not deliver it to the property managers by hand.

The Tribunal found that the lessee has not proved that the December letter was either faxed or posted to the property manager before the 31 December 2002. As this is the only basis upon which the lessee claimed to have exercised the option to renew in accordance with clause 20.1 of the lease, the Tribunal determined that the lessee had failed to prove that he did in fact duly exercise the option.

The Tribunal held that actual receipt of the notice was essential and as the lessee failed to prove that the protocols in respect of the exercise of the option had been followed, the notice had not been effectively served.

### **The Makhoul Case**

*Makhoul v Petria Pty Ltd [2004] NSWADT 51 (10 March 2004)*

In Mackhoul, the Applicant lessee ("Eddie Makhoul"), sought orders for a declaration that the option to renew under the lease for a further six year term had been validly exercised, as well as seeking orders for other matters including the rent for the new term, overpaid outgoings, defining actual leased area and claim for repairs.

The lease was originally entered into between the Applicant together with two other co-lessees ("Gianfranco Inverso, Franco Andreaccio"), and the lessor ("Petria Pty Ltd") for a six year term, commencing on 1 May 1995 and ending on 30 April 2001, with two, six year options of renewal.

It was acknowledged by all parties that the lessee had sent a handwritten letter to the Respondent lessor's agent on 15 January 2001 to advise that he would like to exercise the option on the lease. However, the handwritten letter was signed only by the Applicant and neither of the two co-lessees.

The text of the letter is as follows:

"Dear Nick, I would like to exercise my option on the lease for the premises on 20 Norton Street, Leichhardt, Yours Faithfully, Eddie Makhoul"

The Tribunal found that the letter was a clear and unequivocal statement sufficient to exercise the option. However, it was unable to accept that the request to exercise the option was validly made on behalf of all three lessees and that the plain words in the letter indicated that it was made by the lessee alone.

The lessee tried to rebut this conclusion by adducing evidence of written authorities signed by the other two co-lessees dated 15 September 2003 in the following terms:

"I .....hereby authorise Eddie Makhoul of .....to deal with all matters concerning the Lease and business conducted over and at 20 Norton Street Leichhardt including but not limited to paying rent, exercising the options pursuant to the Lease, hiring and firing of staff and all disputes and all banking."

The Tribunal found that the written authorities did give the lessee the sole conduct and ownership of the business from middle of 1996 onward and that both co-lessees were prepared to be bound for a further six years.

However, since these written authorities were given on a later date than the handwritten letter of 20 February 2001, the option could not be said to be validly exercised with that letter.

The Tribunal went on to look at the letter dated 20 February 2000 from the lessor's agent to all three lessees with the following contents:

"We are in receipt of your request to continue your tenancy by exercise of option in your current lease from PETRIA PTY LTD Subject to an inspection of the premises and your commitment to rectify past damages, we grant on behalf of the Lessors the further term effective 22nd May 2001. The commencement rental for the new period shall be Five thousand, two hundred & fifteen dollars per calendar month, plus G.S.T".

The fact that this letter was headed "without prejudice" was deemed to be prejudicial by the Tribunal. Therefore, this letter was one of the actions which made it difficult for the lessor to deny that the option on the lease was validly exercised. The lessee responded by letter on 19 March 2001 complaining about the proposed 20% rent increase as excessive and counter offered 5%.

On 28 May 2001, a letter was sent to all three lessees by the lessor's solicitor purporting to refuse the option exercise because of the breach of the lease.

On 29 May 2001, there was an on-site meeting attended by all three lessees, the lessor and the lessor's agent. The meeting resulted in an agreement detailed in a letter dated 30 May 2001 and was forwarded to all three lessees. The letter detailed the numerous obligations on the lessee, all of which were conditions precedent to the grant of the extension to the existing lease.

The Tribunal found that this letter superseded the lessor solicitor's letter and that the lessee had put the works into effect by closing the restaurant for 6 weeks in July/September 2001 and had spent over \$50,000 in the refurbishment of the outside and inside of the building.

The Tribunal found that the lessor was estopped from denying that the option was exercised validly due to the whole course of conduct displayed by him inducing the lessee into believing that a full renewal of the lease, in accord with the option, would be granted to the Plaintiff lessee and his co-lessees. This was due to the fact that the lessor had allowed the lessee's right to exercise the option to survive the letter of 20 February 2001 and the letter of offer dated 30 May 200. In addition, the lessor was fully aware of the lessee closing the shop to commence refurbishment in July/September 2001 but did not take any opportunity to stop the lessee from refurbishing the building.

The Tribunal went on to exercise its power to make the order under *s72(1)(c)(i)* ("*Powers of Tribunal relating to retail tenancy claims*") compelling a party to the proceedings to do any work, service or obligation arising under the Act or the terms of the lease.

The Tribunal held that the lessor could not deny that he was bound to offer the lease, in terms of the option, to all three lessees based on the offer of 30 May 2001 and its conduct, and that whether the lessees acknowledged the entitlements and obligations by executing the option was a matter for them.

## **CONCLUDING REMARKS**

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Litigation in New South Wales under the *Retail Leases Act 1994* is a two part system whereby the applicant is required in good faith to submit to mediation (or other appropriate ADR processes) the issues

that are the subject of the claim. If the Registrar is satisfied that attempts at resolving the dispute by mediation are futile, the matter will then proceed to adjudication before the Administrative Decisions Tribunal. Consequently, matters that do proceed to arbitration are usually complex by nature, where the legal principles to be applied in accordance with the provisions of the Act are arguably capable of differing interpretations.

In its continuing objective to treat the Act as an instrument of consumer protection, the NSW government recently strengthened the Act through the incorporation of the 2005 amendments which came into force on 1 January 2006. There is an increased reliance on the “disclosure” provisions under Sections 11 and 11A in terms of the information to be exchanged between landlord and tenant prior to entering into the lease or before the lease is assigned to another person. In particular, the tenant’s disclosure statement enables the tenant to record what statements or representations the shopping centre landlord or agent made, whether oral or in writing, that the tenant has relied upon in entering into the lease. In this respect, the tenant’s solicitor should be encouraging his client to particularise the representations that were made if at some future time the tenant wants to allege misrepresentation by the landlord. The Act provides in s11(2) that the tenant may terminate the lease at any time up to 6 months after the commencement, if the landlord fails to provide a disclosure statement to the tenant setting out the information which the landlord is obliged to disclose to the tenant.

Frequently in retail leasing, the tenant is encouraged to sign an “Agreement for lease” which is essentially a contract to enter into a lease (contract) at a future date. This situation usually occurs when the lease has not been prepared for execution but the tenant is ready to occupy the premises or when a shopping centre or premises is still at the development stage. Tenants should consider whether the term of the lease will be adequate to amortise the expected cost of the fit-out and whether the opportunities for lease renewals and rent reviews are

consistent with the Act. Some landlords insist on the payment of 'turnover rent' which should only be payable at a level in excess of the total of rent, outgoings and GST.

Options for lease renewal have been the subject of considerable discussion in the cases cited above. The value of the "option for renewal" in the landlord/tenant relationship has been emphasised in a separate commentary for good economic reasons. Consequently, tenants should approach the "option for renewal" clauses offered in the lease (or agreement for lease) with caution and insist on the removal of any clauses that would appear to unreasonably act to deprive the tenant of the opportunity to exercise the option. Whilst it may appear to be reasonable that the tenant be precluded from exercising an option for renewal if the tenant is currently in breach of the lease (eg. late payment of rent or breach of another covenant) it is suggested that a provision requiring the landlord to give written notice of such a breach with the right to remedy the situation is a fairer approach in the circumstances where the exercise of an option for renewal is at risk.