



## NEWSLETTER

## PROPERTY LAW

## Landlord audits under lease turnover clauses – how deep can they pry?

Landlords suspicious of their tenants' reported turnover figures can take heart from a recent Western Australian Supreme Court case, *Argyle Holdings Pty Limited v Marvelle Investments Pty Limited* [2008] WASC 7. The Court looked at the extent of the landlord's powers "to audit the daily records of the Gross Receipts and any books of account of the lessee relating thereto" and interpreted the power very widely.

The tenant leased premises in a WA shopping centre, with a permitted use under the lease of "fresh food, gourmet deli and supermarket". The lease contained a turnover or percentage rent clause, under which, essentially, the tenant paid whichever was the higher of the fixed rent or a specified percentage of gross receipts from the business.

At the end of each lease year the tenant had to give a statement accompanied by an audit report from its accountant declaring the gross receipts and certifying their accuracy. The landlord was also given the power to audit "the daily records of the Gross Receipts and any books of account of the lessee relating thereto" and to recover any short payment.

The lease started in November 1995. However, in only one of the succeeding financial years did the turnover rent exceed the fixed rent. Because of the general buoyancy in the economy and in particular in the food trades, the landlord became very suspicious. It appointed an accountant to conduct an audit of the turnover figures and the case concerned what the auditors could insist on looking at.

The landlord and its accountants sought (and the tenant denied their right to) access to:

- all computer generated inquiry reports from the computerised cash register system, as requested by the accountants, for various financial years
- the tenant's tax returns and financial statements for various financial years
- all notes and working papers of the tenant and its accountants containing information relating to the business for these financial years
- an electronic copy of the data file for the computer point of sale system for the relevant years.

The Court made orders giving the landlord's accountants access to the records which they wanted. The Court took a very wide view of the power to audit granted. In doing so, the Court did not think that the right was relevantly constrained by the WA *Commercial Tenancy (Retail Shops) Agreements Act 1985*.

The Court said:

*Restriction of the activities of the accountant appointed to conduct this audit to the materials actually used by the defendant for the preparation and certification of the periodic reports of turnover figures would, to my mind, be a denial of the true nature and character of such an audit. ... There is no allegation of fraud in this case but, notwithstanding that, such optimistic assumptions are not the working hypotheses of auditors. An auditor's role is to check, not merely to accept, the accuracy of records and reported figures and to examine the processing system which has produced them in order to look for mistakes, errors, oversights or misapprehensions*

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*which, experience regrettably reveals, only too often leads to accounting errors. This process of investigation and evaluation cannot be performed only by examining the records which have been relied upon by the lessee to report turnover figures when the obligation of the auditor is to ascertain, as accurately as circumstances can allow, the true turnover figures. Further inquiry is justified and necessary to undertake an evaluation of the business system. Comparisons with external criteria, such as profit margins reported by reputable reports of similar trades, seem to me to be permissible means of assisting in that task ...*

The tenant has since lodged an appeal.

## What can a landlord do when a tenant alters the premises without consent? - Part 2

Landlords will also be reassured by the decision last month of the Full Federal Court of Australia in *Bowen Investments Pty Limited v Tabcorp Holdings Limited* [2008] FC AFC 38. In our August 2007 Property Law Newsletter we reported that in the same case, before a single Federal Court judge (*Bowen Investments v Tabcorp Holdings* [2007] FCA 708), the owner of a newly constructed high quality office building in Melbourne, failed to obtain substantial damages from the whole of building tenant who made major changes to the foyer without the owner's consent. However, the

owner fared much better before the Full Court on appeal.

The owner had sought over \$1.3 million damages, comprising the estimated reinstatement cost and loss of rent during the period in which such works would be undertaken. In the lower Court, the judge had held that the value of the property had not been reduced by the tenant's changes and was only prepared to award a small amount of damages. The Full Court has now overturned this decision, essentially giving the owner what it had claimed.

In this case there was not the usual covenant on the tenant's part that at the end of the lease it would remove all of its alterations and additions and reinstate the building. However the Full Court said this did not matter. Clearly the tenant had breached its covenant not to alter the premises without consent and the Court was prepared to give relief in the same way as if there had been a covenant to reinstate the premises at the end of the term.

The landlord had originally spent a great deal of money designing the foyer to the highest standard, described by the architect as having "a timeless quality". The tenant (without approval and despite the objections of the landlord) had replaced the foyer with a modern one that would suit its image as a "progressive, technologically advanced business".

The landlord was adamant that the original foyer be replaced or that it be compensated for the cost of doing so. The Full Court pointed out that, speaking generally, in cases of damage caused to property in breach of contract, the bases for assessing damages are either the cost of reinstatement or the diminution in the value of the property due to the breach of contract, whatever is

reasonable in the circumstances. However it said an assessment of what is reasonable in a particular case is not to be measured in purely economic terms. Personal preferences of a subjective nature are not irrelevant when choosing the appropriate measure of damages. The Court said that it did not think that the landlord's wish to have the foyer restored had been shown to be unreasonable.

While landlords will be a lot more comfortable with this decision than the original decision given by the lower Court, the saga hasn't finished yet. Tabcorp has appealed to the High Court.

## Heavy expansion of use under easement allowed

The law on what can be done under easements has developed considerably recently, with several appellate court decisions. First there was the important High Court decision in October last year in *Westfield Management Limited v Perpetual Trustee Company Limited* [2007] HCA 45. More recently, the New South Wales Court of Appeal has given judgment in *Sertari v Nirimba Developments Pty Limited* [2007] NSWCA 324. In this case the Court construed a right of carriageway, which previously had been only lightly used, to be available for use benefiting a major subdivision comprising 236 residential units with underground parking for 351 vehicles and ordered the owner of the land on which the right of carriageway was situated to consent to lodgment of a development application for the development.

The right of carriageway, 7 metres wide, was originally created to

give access to a 557 acres parcel of land. The terms of the right of carriageway were wide, with the easement being granted “for all purposes”. This form of wording is widely used in rights of carriageway. The owner of the land over which the right of carriageway ran was liable under its terms to maintain and repair the site of the right of carriageway.

The land benefited by the right of carriageway was subsequently subdivided. On one of the lots of land created, an area of about 2 hectares, the owner applied for development consent to construct two residential flat buildings comprising 236 units with underground parking for 351 vehicles, with access over the right of carriageway. The Court noted that the likely use of the right of carriageway during the construction phase of the residential development and then subsequently, by the occupiers of the units and others, would constitute development of the site of the right of carriageway, because of the major intensification of its use. Accordingly the development application included seeking consent to the use of the right of carriageway for the purposes of the development. As a result, the consent of the owner of the land burdened by the right of carriageway was needed. The owner refused the consent and in the subsequent proceedings argued that the right of carriageway was not wide enough to allow this more intensive use.

The owner of the land burdened by the right of carriageway relied on evidence of extrinsic circumstances and in particular, it relied on the genesis and original purpose of the grant of right of carriageway, in arguing that its terms were not sufficiently wide to allow the proposed use. The Court of Appeal rejected this. Consistently with

the High Court’s decision in the *Westfield* case, the Court said that extrinsic material, apart from the physical characteristics of the property burdened and the property benefited, is not relevant to the construction of easements such as this right of carriageway. The Court said that the words of the grant were clear. It was a right “for all purposes and at all times” and as a result it was wide enough for what was proposed.

The evidence did not establish that the increased use of the right of carriageway for the purposes of the new development would unreasonably interfere with the reasonable use of it by the owner of the land burdened. If the use could have been shown to be likely to cause unreasonable interference, an argument would have been open that it constituted excessive user of the right of carriageway and was accordingly not permitted.

One argument raised was that allowing the right of carriageway to be used for the new development would impose an unfair repair and maintenance obligation on the owner of the land burdened by the right of carriageway and that this constituted a lawful reason for the owner to refuse its consent to the development application. The Court confirmed that an owner of land burdened by an easement could only withhold its consent to lodgment of a development application for use of an easement such as the right of carriageway, for a “lawful reason”. The likelihood of paying increased repair and maintenance costs was not a “lawful reason”, in circumstances where, under its terms, the local council had the power to vary or modify the terms of the right of carriageway. It could accordingly vary the repair and maintenance obligations imposed, to share them equitably. The Court ordered the owner of the land burdened by the

right of carriageway to consent to the development application.

This decision is an important one. By clarifying the law, it potentially opens up for redevelopment sites which rely for all or part of their access on rights of carriageway which were created in very different circumstances and only lightly used in the past. Conversely, landowners now creating rights of carriageway need to be very careful of how they word them. If it is intended that the right of carriageway only be available for a specific limited use, then this needs to be specified in the terms of the right of carriageway.

## Should you be watching over council’s shoulders?

Development consents can be and are challenged by third parties for various reasons and in a number of cases have been held to be invalid. In *Homemakers Supacenta - Belrose Pty Limited v Warringah Council and Narabang Constructions Pty Limited* [2008] NSWLEC 54 a consent granted under delegation was challenged on the grounds that the Council’s resolution purporting to delegate authority was invalid.

In November 2005, Narabang Constructions (**Narabang**) lodged a development application (**DA**) with the Council for a bulky goods outlet. The Council undertook its assessment of the DA and on 26 September 2006, passed a resolution purporting to delegate authority to Council’s General Manager (**GM**). The resolution read:

*“That ...delegation to be given to the General Manager Warringah Council to grant consent... for the construction of a bulky goods shop premises.”*  
(the **Resolution**)



A few months later, the GM granted consent for the DA (the Consent).

Homemakers challenge was based on the allegation that the Resolution was invalid because it only delegated Council's powers to approve the DA and not Council's powers to also refuse the DA or grant consent subject to conditions. Following a recent decision in the Land and Environment Court (**LEC**), both Narabang and Council admitted that the delegation was invalid. In the earlier case, Biscoe J held that the requisite consideration under Section 79C of the *Environment Planning and Assessment Act 1979* (NSW) (**EP&A Act**) cannot be given if a delegate only has power to approve a DA and not refuse it. The findings were upheld in the Court of Appeal in *Belmorgan Property Development Pty Limited v GPT Re Ltd* (2007) 153 LGERA 450.

In the Homemakers case, having found there was a breach of the EP&A Act, the Court then had to decide whether to exercise its discretion and declare the Consent invalid. Weighing up the factors referred to by Kirby P in *Warringah v Sedevcic* (1987)10 NSWLR 335, the Court considered that it was appropriate to grant the order sought by Homemakers, namely that the Consent was invalid.

Narabang, in turn, sought an order under Section 25B of the *LEC Act 1979* (NSW). That section enables the Court to suspend the operation of a consent in whole or in part and to specify terms, the compliance with which will validate the consent.

Foremost in the Court's mind when considering whether to grant the Section 25B order was that all of the Council officer's reports had recommended approval and no major issue was yet to be considered by Council. Thus while the failure to properly delegate functions under the EP&A Act was significant, in this particular case, her Honour Pain J felt that appropriate Section 25B orders could be drafted to in effect 'remedy' the Consent.

Whilst the consent was able to be ultimately "remedied" here, if the facts had been a little different, that might not have been the case. This case reinforces the point that it is worthwhile watching over council's shoulders when it is considering determining a DA, to reduce the risk of a successful challenge.

**For more information please contact:**

**Dr Nicholas Brunton**  
Direct line +61 2 9947 6330  
Email [nicholas\\_brunton@hdy.com.au](mailto:nicholas_brunton@hdy.com.au)

**Henry Davis**  
Direct line +61 2 9947 6314  
Email [henry\\_davis@hdy.com.au](mailto:henry_davis@hdy.com.au)

**Jennifer Degotardi**  
Direct line +61 2 9947 6646  
Email [jennifer\\_degotardi@hdy.com.au](mailto:jennifer_degotardi@hdy.com.au)

**Shane Martins**  
Direct line +61 2 9947 6322  
Email [shane\\_martins@hdy.com.au](mailto:shane_martins@hdy.com.au)

**Andrew Steele**  
Direct line +61 2 9947 6640  
Email [andrew\\_steele@hdy.com.au](mailto:andrew_steele@hdy.com.au)

**Elizabeth Wild**  
Direct line +61 2 9947 6610  
Email [elizabeth\\_wild@hdy.com.au](mailto:elizabeth_wild@hdy.com.au)

**Colin Windeyer**  
Direct line +61 2 9947 6317  
Email [colin\\_windeyer@hdy.com.au](mailto:colin_windeyer@hdy.com.au)

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