



NEWSLETTER

PROPERTY LAW

What can a landlord do when a tenant alters the premises without consent?

In the case of *Bowen Investments v Tabcorp Holdings Limited* [2007] FCA 708, the owner of a newly constructed high quality office building in Melbourne, failed in seeking substantial damages from the whole of building tenant who made major changes to the foyer without the owner's consent.

Nearing the time of completion of construction of the building (in late December 1996), the landowner entered into a whole of building lease with a major tenant. The lease contained the usual provisions prohibiting any alterations without the landlord's consent, but did not contain the usual provisions requiring the tenant, prior to termination of the lease, to remove all of its alterations and additions and reinstate the building.

The building had been completed with an impressive high standard foyer. However, the tenant wanted a bigger and different style foyer, which it regarded as more consistent with its image. The court found that in around mid-1997 the tenant had proceeded to tear out the landlord's foyer fitout and replace it with its own (at the same time enlarging the foyer at the expense of lettable area), *without* first obtaining the landlord's consent.

The landlord objected vigorously and at one point of time sent a lawyer's letter demanding that the foyer be "*immediately restored to its original condition*" and threatening legal action.

A meeting was held and correspondence crossed. The tenant contended that the landlord had consented and the landlord insisted it had not. The matter seems to have drifted on for about 5 years, to the time of a market rent review. The parties could not reach agreement on the new rent and at that time they each forcefully restated their respective positions on the foyer. The dispute over rent was ultimately resolved by determination of an independent valuer.

The landlord brought an action on various grounds against the tenant, principally seeking damages. It claimed \$1.38 million in damages, made up of the estimated cost of reinstatement of the foyer to its former condition (\$580,000) and loss of rental income during the 4 month period in which such works would need to be undertaken (\$800,000).

Evidence given was to the effect that the foyer constructed by the tenant was of an inferior standard to that originally provided by the landlord.

The court held as follows:

In some cases it may be appropriate to award damages on the basis contended for by the applicant [landlord]. This will be so in the relatively narrow range of cases where a tenant has so damaged or modified premises that they are unlettable at the conclusion of the lease ... Normally, however, reinstatement costs will not be awarded unless there exists some special interest in reinstatement arising from a radical change to the usage to which the property can be put following renovations by the tenant.

The landlord's claim was made more difficult by evidence accepted by the court that at the expiry of the lease there would be likely to be little if any diminution in value of the premises caused by the tenant's renovation of the foyer. Furthermore,

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extensive renovation of the foyer, according to the evidence, would be necessary in any event at the end of the lease.

In the end the court awarded damages to the landlord of only some \$34,000, being the costs of merely restoring the previous lettable area of the ground floor (without restoring its finishes).

This raises the interesting question of how different the result would have been had the lease contained the usual clause to reinstate the premises to their original condition at the expiry of the lease.

In the *Bowen Investments v Tabcorp* case the Federal Court referred to an old UK Court of Appeal decision which had looked at this exact question. This was the case of *James v Hutton* [1949] 2 ALLER 243. In that case a tenant had “modernised” the façade of the leased premises, but the lease required that the tenant would, if required, reinstate the premises to their original condition. The landlord gave notice to reinstate, but the tenant failed to do so. The Court of Appeal refused to award damages calculated by reference to the probable costs of restoring the original façade. The Court of Appeal applied the general rule as to damages for breach of contract, namely, that the landlord could only obtain compensation for damage actually suffered. In the end, only nominal damages were awarded, on the basis the court believed the landlord had suffered no actual damage.

The *Bowen Investments* case also shows the importance of parties seriously considering offers to settle such proceedings. In the *Bowen Investments* case the tenant had made an offer of compromise for \$140,000, ie, over three times the amount the landlord was ultimately awarded. In addition to receiving only a very minor award of damages, the landlord also

ended up paying a large part of the tenant’s legal costs as well as its own. This ended up being a very heavy impost, as the hearing had run for some 10 days and both parties had both Senior and Junior Counsel.

Most landlords are likely to be uncomfortable with this result. When confronted with alterations to their building carried out by a tenant (either with or without consent), most will want to have the right to recover the cost of restoration of the building, if the tenant fails to do so. They will not be comfortable being confined to damages based on valuers’ assessments of reduction in the value of the building. In the *Bowen Investments* case, the landlord would have been in a better position, had the lease clearly obliged the tenant to restore the building and included provisions clearly allowing the landlord to do this work if the tenant failed to, coupled with a substantial and sufficient bank guarantee available for the landlord to draw on.

Toll charged for use of land without agreement

The recent Victorian Supreme Court case of *Fox v Toll Properties* [2007] VSC 138 was concerned with unauthorised continuing use of part of an industrial property by Toll Properties and resulted in Toll being ordered to pay for the use of the property.

The facts were somewhat complex. However, put simply, a predecessor of Toll (from whom Toll had bought the business and obtained a licence to use the property) previously leased an office and warehouse property with a substantial rear yard (the ARN property). The ARN property had

been used in conjunction with an adjoining property leased by Toll’s predecessor (the Toll property) and the dividing fence which had previously been between the properties had been removed, to facilitate the use of both properties together.

The court found that the lease of the ARN property had come to an end and that the property has been vacated. However, after detailed evidence, the court held that Toll had consistently continued to use the rear of the ARN property (essentially as an appendage of the Toll property next door) for its business. The amount of its use had changed according to Toll’s requirements, but the court nevertheless found a pattern of ongoing unauthorised use of the rear yard of the ARN property. The court said that, at least at the outset, the use by Toll of the rear of the ARN property was as a trespasser. The court left open that due to some knowledge of Toll’s activities by the landlord, its use of the rear of the property may have later been on some basis other than as a trespasser. The court thought that however one characterised Toll’s use of the land, Toll had derived a substantial commercial benefit in using the land and the owner of the land was entitled to damages for such use. These damages were the rental value of the part of the property used for the period of use. Toll was ordered to pay market rental for the rear yard over the period of its use.

Vendor’s valuer liable to purchaser for incorrect valuation

In a recent case, the Court of Appeal in Victoria decided that a valuer engaged by the vendor

under a contract for sale of land to determine the value of the land for the purpose of applying the margin scheme (under the GST Act), was liable to the purchaser for an incorrect valuation which led to an overpayment of GST. The case was *Derring Lane Pty Limited v Fitzgibbon* (2007 VSCA 79).

The contract provided that the purchaser was liable for GST but could elect to require the vendor to apply the margin scheme. The purchaser made the election and the vendor obtained a valuation of the land as at 1 July 2000. The valuer valued the land at that date at \$1.1 million. As a result of the valuation, the purchaser became liable under the contract to pay GST on a margin of \$1,150,000. In the proceedings, the purchaser claimed that the true market value at 1 July 2000 was \$1.08 million and that consequently the purchaser paid \$70,000 more in GST than it should have.

The valuation included a disclaimer that it was only for the use of the person to whom it was addressed (the vendor) and could not be relied on by any third party. However, the valuer conceded during the trial that he knew the valuation was required for the purpose of calculating GST under the contract.

The Court held that the disclaimer could not be construed as meaning that the valuer was not responsible for the use of the valuation for its acknowledged purpose even where the loss was suffered by another person. Consequently in this case the disclaimer was ineffective to preclude a claim by the purchaser.

The Court of Appeal found that as the contract was drafted, the purpose of the valuation was to facilitate the calculation of the amount payable on completion by the purchaser. If the purchaser had not paid the amount so calculated it would have been in breach of the contract. In these circumstances it

is not necessary to prove that the purchaser relied on the valuation and paid the relevant amount because it thought the valuation was correct.

Landlords unreasonably withholding consent under leases

In most Australia states, legislation provides that where a lease contains a covenant against either the making of an improvement without the landlord's consent, or the assigning of a lease without the landlord's consent, the landlord may not unreasonably withhold consent. In NSW for example, the relevant provision is section 133B of the Conveyancing Act 1919.

There have been a lot of cases over the years on landlords refusing consent to an assignment. However, a recent New South Wales Court of Appeal case late last year, *Skiwing Pty Ltd v Trust Company of Australia t/a Stockland Property Management* [2006] NSWCA 276, examined when it is unreasonable for a landlord to withhold its consent to a tenant's request to make "improvements".

In the *Skiwing* case, the tenant proposed extending the floor area of the premises to add a balcony. The balcony would extend beyond the leased premises and into airspace owned by the Council. A clause of the Lease prohibited the tenant from making "improvements" to the leased premises without the landlord's consent. The question arose whether the proposal to add a balcony constituted an "improvement" within the meaning of both the Lease and section 133B(2) Conveyancing Act (NSW).

The court referred to a well settled principle that whether something

is an "improvement" is to be considered from the viewpoint of the tenant. The Chief Justice referred to English authority, which applied the equivalent English provision in circumstances where a tenant requested the landlord's consent to enlarge a leased premises by removing a wall and extending the premises. The court found that this case may be applied to the interpretation of section 133B(2), and that the Landlord in the *Skiwing* case could only withhold its consent to the balcony proposal on reasonable grounds. On the facts, the court regarded the landlord's refusal of consent as unreasonable.

The court also considered whether a tenant could recover damages for a landlord's wrongful withholding of consent to proposed improvements. The court pointed out that, based on existing authority, damages would not generally be available for the wrongful withholding of consent to an *assignment* of lease. In such a case, the tenant's remedy would rather be to actually proceed with the assignment without consent. The court suggested that much the same principles might apply to wrongful withholding of consent to proposed improvements, but made it clear that the judgment should not be regarded as a precedent on this issue, as it had not been properly argued in the case.

A very different result occurred in a different context in the New South Wales Court of Appeal case of *Cripps v G&M Dawson Pty Ltd* [2006] NSWCA 81. This case examined the consequences of a landlord unreasonably withholding its consent to a proposed assignment of a retail lease. Section 39 of the *Retail Leases Act 1994 (NSW)* limits the circumstances in which a landlord may withhold its consent to an assignment of a lease. In this case, the tenant had requested the right to assign its lease in conjunction



with the sale of its photographic business. The sale was frustrated by the landlord's wrongful refusal to consent to the assignment of the lease. 10 months later the business was sold, however it yielded \$102,000 less than the earlier attempted sale.

Between the attempted and actual sale there had been a substantial drop in the value of the tenant's photographic equipment with the advent of digital technology. Its equipment with the old technology was a principal asset of the business. The court found that the landlord had wrongfully withheld its consent under the *Retail Leases Act*, and awarded the tenant \$102,000 in damages for loss of opportunity to sell the business during the first sale attempt. The tenant's loss was seen as a loss that may reasonably be considered as arising naturally, according to the usual course of things in a falling market, from the landlord's breach of contract.

Perils in buying from Councils again – in Queensland

In our July edition we reported on the NSW case of *Bonaccorso v City of Canada Bay City Council* [2007] NSW LEC 159, where a purchaser ended up losing land transferred to it by a NSW council, notwithstanding registration of the transfer, because the Council did not have power to transfer the land.

A couple of months ago, in *Whitsunday Shire Council v Laguna Australia Airport Pty Ltd* [2007] QSC 084, the Supreme Court of Queensland held that a contract entered into by a Queensland Council for the sale of airport land and an airport business was unenforceable, on the grounds that the Council had no power to sell the land.

The case arose out of an agreement entered into in 2001, between Whitsunday Shire Council and Laguna Australia Airport, for the Council to sell in its interest in the Whitsunday Airport (in one place described as including a leasehold interest) to Laguna for market value. Laguna were developers of a nearby resort. The airport was on Crown land. The Council in fact did not have a leasehold interest. Indeed it only held the land as trustee for the Queensland Government under the *Land Act 1962* (Qld). A condition of the sale was that the Queensland Minister of Natural Resources and Water would need to consent to the "proposed transfer of the Council's leasehold interest". Not surprisingly, this consent was not forthcoming. Instead, the Minister authorised the Council to enter into a trustee lease with Laguna. Protracted negotiations failed to result in a concluded agreement on the terms of the trustee lease.

The Council applied to the Court for a determination of the matter. The Court held that the agreement between the Council and Laguna to sell the airport was unenforceable,

as the Council did not have a saleable interest in the land and the purported disposition of its interest was contrary to the *Land Act*. Laguna was also ordered to pay the Council's costs.

Laguna claims to have spent significant funds on its nearby resort development, in anticipation that it would also be the airport operator. The case reinforces the importance for purchasers from Councils of properly checking the Council's actual interest and power to dispose of the land, at the earliest practical time.

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