



NEWSLETTER

PROPERTY LAW

“Fair Wear and Tear”, “Structural Damage” and other common lease terms

Landlords and tenants frequently brawl over make good and required repairs. In *Alamdo Holdings Pty Limited v Australian Window Furnishings (NSW) Pty Limited* [2006] NSWCA 224, the NSW Court of Appeal looked at the meaning of some common leasing terms, which are often at the centre of these disputes.

Background

The case involved a lease between Alamdo Holdings as landlord and Australian Window Furnishings as tenant, of an industrial property in Chester Hill, New South Wales. The lease was for a term of 10 years over land which contained two large factory buildings and a number of bitumen pavement areas adjacent to the buildings.

The proceedings arose from damage caused to bitumen areas surrounding the factories. The damage to the bitumen fell into two categories, areas 1-3 and areas 4-7. Areas 1-3 had suffered significant damage as a result of a subtenant using the area for the storage of heavy containers, equipment and machines. Areas 4-7 had suffered less serious damage in the form of cracking and potholes (this damage was not caused by the storage of heavy equipment by the sub-tenant).

The key issues before the court were whether:

1. the repairs to areas 1-3 could be classified as “structural repairs” and whether the tenant was liable for such repairs pursuant to clause 5.1 of the lease. In short, clause 5.1 provided that the tenant was only liable for structural repairs which “were rendered necessary by any act or omission or default on the part of the lessee or by the lessee’s use of occupancy of the demised premises”; and

2. the damage to areas 4-7 fell within the “reasonable wear and tear” exception under clause 5.1 of the lease.

Were the repairs to bitumen areas 1-3 “structural repairs”?

The trial judge (with whom the Court of Appeal agreed on this point) started off by saying that maintenance, replacement or repair that is “structural” can be undertaken only in relation to something that is a “structure”, although not everything done by way of maintenance, replacement or repair in relation to a “structure” is properly classified as “structural”.

He went on to approve the following passage from an earlier NSW judgment:

“Structure” of course is a word of which the meaning varies considerably according to the context and the phrase “structural character” or “defect of a structural character” varies correspondingly. Literally “structure” means something which has been constructed and “defect of a structural character” means either a fault in putting the structure together or some subsequent failure

on the part of the structure to remain satisfactorily put together.

The judge also quoted the Victorian case of *Carbure Pty Ltd v Brile Pty Ltd* [2002] VSC 272, which held that cosmetic cracks that do not threaten the load bearing integrity of a building and are able to be repaired by straight forward work, such as patching or painting, will not be regarded as a structural defect requiring structural repair.

In this case, the Court of Appeal endorsed the trial judge’s decision that the bitumen was a “structure”, as it made the pavement areas usable by providing the necessary hard surface and support and that the repairs were “structural” as they were required to keep the bitumen “satisfactorily put together”.

Was the damage to bitumen areas 1-3 caused by the tenant’s use of the premises?

The decision turned on the wording of clause 5.1 and specifically whether the repairs had been “rendered necessary” by the tenant’s “use” of the premises. The Court of Appeal agreed with the trial judge’s decision and held that whilst the tenant had used the premises for subletting purposes, this

IN THIS ISSUE

had not caused the damage. The repairs had, according to the court, been rendered necessary by an independent activity (or “use”) of the sub-tenant.

This decision highlights the importance of the drafting of lease clauses. From the landlord’s perspective, clause 5.1 in this case should have been drafted more widely to ensure that the tenant was liable for any structural damage caused by its sub-tenants, licensees etc.

Did the damage to bitumen areas 4-7 constitute “reasonable wear and tear”

In a split decision, the majority of the Court of Appeal agreed with the trial judge that the damage to areas 4-7 was “reasonable wear and tear”, because it was caused by the ordinary operation of natural forces and “*was symptomatic of decomposition and deterioration inherent in asphalt paving and to be expected in the ordinary course*”.

However, the inability of the Court of Appeal to agree highlights the difficulties which can be faced by parties in determining their legal obligations and rights in respect of repair and make good. The inability to agree arose on how to apply the important principle in *Haskell v Marlow* [1928] 2KB 45. The principle in *Haskell v Marlow* operates as a major qualification on the standard reasonable wear and tear exception.

That principle applies where the ordinary operation of natural forces results in a condition which could be regarded as something to be dealt with by ordinary maintenance, and which would, if not attended to, cause damage going substantially beyond what could reasonably be considered reasonable wear and tear. In such cases, a tenant who has covenanted to maintain and repair, reasonable wear and tear excepted, will be required to carry out normal maintenance

so as to prevent this kind of damage, even though the initial condition could fall within the term “reasonable wear and tear”.

In the present case, the majority of the court accepted that although the initial cracking of the bitumen areas had become more pronounced (due to water intrusion), the subsequent damage (in the form of crocodile cracking and potholes) did not go substantially beyond reasonable wear and tear.

Co-ownership Disputes – Lend Lease and GPT

The case of *Lend Lease Real Estate Investments & Anor v GPT Re Limited* [2006] NSWCA 207 arose from the recent Lend Lease/GPT/Westfield imbroglio. It involved the Court of Appeal construing a pre-emptive rights clause in a co-ownership agreement between Lend Lease and GPT. The case has serious implications for all parties to co-ownership arrangements.

In June 2005, GPT resolved to terminate Lend Lease’s long-standing role as responsible entity of GPT and to sell certain assets to Westfield. Earlier, Westfield had been instrumental in defeating a proposal by Lend Lease to merge with GPT.

One such asset was half of GPT’s 50% stake in the Sunshine Plaza Shopping Centre in Queensland. The other 50% owner of the Centre was Lend Lease. GPT entered into put and call options with Westfield in respect of half of GPT’s share (ie a 25% stake in the Centre). However, the options were conditional upon Lend Lease waiving certain pre-emptive rights under the co-ownership agreement.

Under the co-ownership agreement, neither party could “deal” with all or part its interest unless it offered the same interest to the co-owner on the same terms (except the price, which was to be market price as determined by valuation).

After the price was determined, the selling party could revoke its offer. However, where a party was in default, and did not remedy the default within a prescribed grace period, it was deemed to have irrevocably offered the co-owner the whole of its 50% interest.

Thus, any unremedied default by a co-owner presented a golden opportunity for the other co-owner to acquire the defaulting co-owner’s entire interest. Lend Lease sought to take advantage of the clause. It argued that GPT’s entry into the put and call options was a default, because it involved a “dealing” with GPT’s interest without first offering the interest to Lend Lease. That default, said Lend Lease, meant there was a deemed irrevocable offer to Lend Lease of GPT’s entire 50% interest.

This case was an appeal by Lend Lease to the NSW Court of Appeal against a decision of the trial judge, who had found that the pre-emptive rights provisions were not triggered by GPT’s entry into the put and call option, and that GPT had not defaulted.

The first issue considered by the Court of Appeal was whether GPT “wished to deal” with its interest, and if so, whether this obliged GPT to offer to sell to Lend Lease. The court found that, as a matter of fact, GPT did “wish to deal” with its interest. However, the clause did not mean that, once it formed a “wish to deal”, GPT was automatically obliged to offer the interest to Lend Lease. The clause was merely facultative: if GPT wished to deal with its interest, it could only deal with the interest if it first offered the same terms to Lend Lease.

The second issue was whether entry into conditional put and call options was itself a “dealing”. “Deal with” was defined in the co-ownership agreement as follows:

‘deal with’ means any sale, assignment, transfer, disposition, declaration of trust, assumption of obligations or other alienation (other than

leasing, licensing or granting occupation rights) or granting other like rights and whether affecting legal or equitable interests and expressions cognate to 'deal with' will have a corresponding meaning.

Applying the intriguingly named principle of construction known as *copulatio verborum*, the court found that “deal with” was limited to an alienation of GPT’s interest. Despite the width of “assumption of obligations”, that phrase was qualified by the next words “or other alienation”.

The court found that entry into the put and call options was not an alienation of GPT’s interest in the property, because the options were subject to a waiver of the pre-emptive rights. No transfer of GPT’s interest would occur unless Lend Lease waived its rights.

Ironically, the trial judge indicated that if the co-ownership agreement had not defined “deal with”, then he would have held that the entry into the options was a dealing, which would have triggered Lend Lease’s pre-emptive rights, even though the options were conditional on a waiver of those rights. The Court of Appeal did not comment in that regard.

In light of this case, co-owners must be careful when agreeing to sell an interest to a third party. In this situation, a common approach is to do what GPT did, namely to enter into an arrangement which is conditional on the co-owner’s waiver of its pre-emptive rights. This case shows that approach may not always be the right one. Depending on the wording of the co-ownership agreement, even a conditional third party arrangement may be a dealing which triggers the other co-owner’s pre-emptive rights. Thus, when entering into a co-ownership agreement, one should consider negotiating a clause whereby conditional arrangements with third parties will not trigger the other co-owner’s pre-emptive rights.

Conversely, if a wide meaning for “dealing” is desirable (in order to limit the range of transactions another co-owner can enter into without triggering your pre-emptive rights) then you need to consider the Court’s approach to construction in this case.

Lessor’s Right of Entry to “Examine” premises for potential contamination

A recent Victorian Court of Appeal case looked at the ability of a landlord under an old lease to enter onto the property and test for contamination. The tenants denied the landlord had this right and threw every possible obstruction in the landlord’s way. The tenants vigorous opposition threatened to derail the landlord’s proposed redevelopment of the property and forced the landlord to fight all the way through the courts.

Facts

Bradto Pty Ltd and Tymbook Pty Ltd were tenants of commercial premises, pursuant to Crown leases of some 50 years duration. The State of Victoria wanted to develop the site and expressions of interest were called for. In order to provide relevant information to the tenderers, the State sought and claimed that it was entitled to, pursuant to the leases, access to inspect and test for asbestos and other contamination. This was likely to involve the drilling of holes, the taking of samples and the like. Such access was vigorously opposed by the tenants.

The State claimed that it was entitled to carry out the tests pursuant to a covenant in the following terms, which required the tenant to:

... permit [the landlord] ... at all reasonable times to *enter upon and examine the state and condition of the demised premises* and will repair and make good all defects specified by written notice given to the lessee by [the landlord] within one calendar month after service of the notice ... [emphasis added]

Bradto and Tymbook argued that the above clause authorised the landlord to enter and examine the state and condition of the respective premises for one purpose only: for the repair and making good of defects in the premises. That purpose did not extend to inspecting for asbestos or taking soil samples to test for contamination. On the other hand, the State argued that the clause conferred on the landlord a general right to enter in order to examine “the state and condition” of the premises.

Tymbook further argued that the word “examine” in the relevant clause was limited to visual inspection and did not extend to the tests proposed by the landlord.

Findings

The Tribunal at first instance preferred the landlord’s arguments and granted the interlocutory injunction sought by the State. Bradto and Tymbook appealed on various grounds first in the Victorian Supreme Court and then in the Court of Appeal ([2006] VSCA 89) without success. In both cases the courts upheld the Tribunal’s assessment that the issues of dispute between the parties established that there was a “serious question to be tried” and that the balance of convenience warranted the grant of an injunction in the State’s favour prohibiting the tenants from preventing access to the premises to the landlord.

On the core issue of whether the leases gave the State a general right of entry to examine “the state and condition” of the premises, the Court of Appeal found that there



was a serious question to be tried, and although not required to do so, indicated that it favoured the interpretation put forward by the State.

Similarly, the Court of Appeal agreed with the trial judge's interpretation of the word "examine", holding that (so far as it was necessary to determine the matter) the word conferred on the landlord more than just a right to visually inspect the premises as contended by the tenants.

Conclusion

Although the Court of Appeal was not required to conclusively determine the issues in dispute, this case provides some authority for the proposition that, at least in leases where contamination is not addressed, the landlord can often rely on other more general rights, like the right to examine the state and condition of the premises, to carry out tests for potential contamination. Having said that, the landlord's rights will always depend on the construction of the relevant lease terms and not all lease covenants will lend themselves to such a broad interpretation.

The sins of the parent ... Victorian contaminated land law changes

In Victoria, amongst other changes to the *Environment Protection Act (EP Act)*, recent amendments to section 62A have given new powers to the Victorian Environmental Protection Authority (EPA) to direct a company to remediate contamination, if the company had "control" of a subsidiary,

related entity or associated entity (**related entity**), when the related entity caused or permitted the contamination. The test for "control" is the same one set out in the *Corporations Act* (section 50AA). There is an additional requirement, in addition to "control", before the "parent" company (**parent**) can be directed to clean up. Either the parent or its directors must have been aware of the related company's conduct, or it must be reasonable to expect that the parent company or its directors would have been aware of such conduct. However, there is what is essentially a defence. A parent company can avoid a clean up liability if it took all reasonable steps to prevent the relevant conduct of its related entity.

In addition, both Victoria (section 66B *EP Act*) and NSW (section 98 *Contaminated Land Management Act*) have provisions which enable the state EPA to proceed against directors and other persons concerned in the management of a company, if the company fails to comply with a clean up notice (or commits some other offence under the Act). Both States laws provide defences under which the director or person concerned in management of the company can escape liability, for example, where they used all due diligence to have the company comply with the clean up notice. Previously, in both States, one of the available defences was that the director or manager had no knowledge of the company's failure. Victoria has taken this opportunity to strengthen section 66B EP Act by removing this defence.

However, the changes to section 62A EP Act are probably more significant. A parent company with

"control" over a related entity can be liable for contamination caused by the related entity, even if there has been no clean up order against the related entity. The EPA can elect to proceed against the parent rather than the related entity.

For more information please contact:

Colin Windeyer

Direct line +61 2 9947 6317

Email colin_windeyer@hdy.com.au

Dr Nicholas Brunton

Direct line +61 2 9947 6330

Email nicholas_brunton@hdy.com.au

Henry Davis

Direct line +61 2 9947 6314

Email henry_davis@hdy.com.au

Jennifer Degotardi

Direct line +61 2 9947 6646

Email jennifer_degotardi@hdy.com.au

Shane Martins

Direct line +61 2 9947 6322

Email shane_martins@hdy.com.au

This newsletter is general in nature and its brevity could lead to misinterpretation. No responsibility can be accepted for those who act on its contents without first consulting us and obtaining specific advice.

If you would like to update your contact details, or you no longer wish to receive this publication, please contact Marketing on +61 2 9947 6000 or email marketing@hdy.com.au