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About the Author

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Termination of Leases

A. In the current challenging retail climate, consideration of termination of leases is a relevant factor for both landlords and tenants.

B. It can be seen that this year retail trade has been probably the most difficult for many years.

C. For landlord clients, termination may need to be considered in circumstances where the tenant is in substantial arrears or substantial breach.

D. For a tenant if the tenant is experiencing trading difficulties and is having difficulty in meeting its rental obligations under the lease, the tenant will need to be aware of its rights and the risk of termination.

A. Adequate Security

1. Ideally the time to consider breach should not be when the breach occurs but rather prior to entry into the lease.

2. It is relevant enquiry as to whether or not adequate security has been provided to secure the obligations of the tenant under the lease.

3. This is a preliminary question.

4. This question needs to be considered at the Heads of Agreement stage not when the tenant is in breach well after the lease has been executed.

5. Sometimes, the right choice is for the landlord not to grant the lease if the landlord is not satisfied there is adequate security or the landlord is not satisfied that the tenant has the appropriate skills to operate the business.

6. Another issue is to timely follow up a tenant who is late paying in rent.

7. If a landlord leaves the follow up too long and waits until the debt is too significant, it can be difficult to negotiate a resolution to the matter.

8. Further, the fact that the landlord has not followed up can create a false sense of security.

9. Good management and timely follow up of late payment of rent can of itself be a significant factor in lease compliance and cannot be underestimated.

B. Can a tenant break a lease

1. A tenant may approach their solicitor to ask if there is a way that the tenant can exit the lease.

2. We wish to summarise four possible avenues that should be explored - firstly, whether or not the retail lease has been complied with, secondly, whether the landlord has derogated from the grant of the lease, thirdly, assignment and fourthly negotiate a surrender.

(a) Retail Leases Act

(i) No disclosure Statement

If the Tenant has not been served with a Lessor's Disclosure Statement, the Tenant has a right to terminate the lease within the first 6 months (Section 11(2) *Retail Leases Act*) and claim its reasonable costs of entering into the lease including its reasonable costs of fitting out the premises (Section 11(2A) *Retail Leases Act)*

(ii) Not served 7 days before the lease was entered into

If the Lessor's Disclosure Statement was not served 7 days before the lease was entered into, the tenant can terminate the lease within the first 6 months (Section 11(2) *Retail Leases Act*) and claim its reasonable costs of entering into the lease including its reasonable costs of fitting out the premises (Section 11(2A) *Retail Leases Act)*

(iii) Disclosure Statement materially false or misleading of incomplete

If the Lessor's Disclosure Statement is materially false or misleading or incomplete a tenant can terminate a lease within the first 6 months and claim its reasonable costs of entering into the lease including its reasonable costs of fitting out the premises (Section 11(2A) *Retail Leases Act)*.

However, there is a limitation on this terminated if the landlord had acted reasonably and honestly and the tenant is not in a substantially worse position (Section 11(3) *Retail Leases Act*).

(b) Derogation from the grant

In difficult situations it is worth considering whether or not the landlord has derogated from the grant of lease itself to give rise to the common law right of termination.

Whilst these will be rare there are cases where the landlord's conduct is such that this right of termination can arise. In such cases, this common law right should not be overlooked.

(c) Assignment

If a tenant is wanting to exit a lease it is appropriate to consider if the tenant can find a purchaser to its business or an assignee of the lease. The tenant would have to be able to satisfy the assignment provisions under the lease (being in mind that the Act will override the Lease).

(d) Negotiate a surrender

It is often forgotten that, notwithstanding the terms of the lease, if a tenant wishes to exit a lease the tenant can approach the landlord to negotiate to pay a surrender sum to surrender the lease.

The actual amount of the surrender sum is subject to negotiation.

There can be a win/win outcome whereby the landlord is able to replace the tenant with a more appropriate tenant and the tenant can exit its obligations under the lease.

Can a landlord terminate the lease for the tenant's breach

1. Before proceeding down this path, please confirm your instructions. Does the landlord really want you to terminate the lease or does the landlord simply want the rent to be paid?

2. Too often a solicitor can assume that termination is the outcome the landlord wants when in fact termination could be the outcome of last resort.

3. It is important to fully understand your instructions.

4. Section 129 *Conveyancing Act* requires a landlord to give notice of breach and to provide the tenant with a reasonable time to rectify such notice prior to termination.

5. However in relation to non-payment of rent no notice is required (Section 129 (8)).

6. Termination is effected by either a court order or physical re-entry.

7. In nearly every case a landlord would terminate by physical re-entry because it could take many months to obtain a court order for possession.

8. If a lease is terminated by physical re-entry after the lease is terminated the landlord should write to the tenant advising the tenant the lease has been terminated and provide the tenant with an opportunity to remove its property and make good the premises.

9. Failure to provide such notice and opportunity to the tenant can result in the landlord's conduct amounting to conversion and can be entitled to the payment of substantial damages to the tenant.

10. It is surprising in practice how often landlords do not understand this obligation and in fact some landlords think they can simply take the tenant's property that is remaining on the premises at the time of termination.

11. I have been involved in matters where the landlord has taken the cash takings from that day's trade. Termination must be carefully handled.

12. Sometimes it is advisable, if there is an agent, for the agent to supervise the access to the tenant to ensure that the tenant does not cause any further damage to the property.

13. If a lease is properly concluded the landlord must remember to return the bank guarantee once the tenant's obligations are complete and this should occur within two months if the Retail Leases Act applies (section 16BA *Retail Leases Act*).

14. A termination of was recently considered by the Appeal Panel in the case of *Charlie Bridge Street Pty. Ltd v Petrazzuolo* [2019] NSWCATAP 184:

    Section 129 *Conveyancing Act* requires a landlord to serve a notice specifying a breach, and allow the tenant a reasonable time to rectify the breach, before the landlord is entitled to terminate the lease.

    However, this does not apply if the breach relates to non-payment of rent (section 129(8) *Conveyancing Act*).

    For non-payment of rent, usually the lease states the period of late payment before the landlord can terminate the lease. Typically, this period is 14 days.

    If the lease provides that the landlord can re-enter and terminate the lease if the tenant is in breach of the obligation to pay rent for a period of 14 days then the landlord can terminate without notice after expiry of this 14 day period.

    It is open to debate whether the law should require a notice to be served on a defaulting tenant when the breach relates to non-payment of rent.

    From a landlord perspective, this could create difficulty as the landlord may have to continually serve notices to a tenant who is constantly in arrears and who ultimately rectifies its breach prior to expiry of the notice period (however the costs associated with the notice would almost always, under the lease, be the responsibility of the tenant). If the landlord served a defective notice (for example, not in accordance with the service provisions under the lease), and the landlord proceeded to terminate, the landlord would be exposed to a claim for damages (which could be substantial).

    However, the alternate argument is that to terminate the lease has severe consequences for the tenant-it results in damage to the tenant's business, including the inability to trade (yet the tenant still has to incur all other business expenses with

no income being generated from the premises) and, what if the non-payment of rent was simply due to a bank error or an oversight? Should not the tenant be made aware of its breach and provided an opportunity to rectify its breach? Further, most landlords would want the rent paid rather than the lease terminated.

I suggest that even if the lease does not require it, in most circumstances, as the landlord usually wants the rent paid, it is advisable that a breach notice be served regardless.

Some leases require the service of a notice even if the breach relates to non-payment of rent. When acting for a tenant, I always request such an amendment. Some landlords already include such notice requirements to avoid suggestion that the lease provisions amount to unfair business practices and could be subject to scrutiny.

The validity of such lease provisions has been considered by the Appeal Panel of NCAT in *Charlie Bridge Street Pty. Ltd v Petrazzuolo* [2019] NSWCATAP 184 which was an appeal from a decision of the Tribunal at first instance.

In this case, the parties entered into a 5 year lease, with a 5 year option for premises on George Street, Sydney. The lease commencing on 1 June 2016 and provided for a 50% rent reduction for the first 12 months of the term. The tenant operated a cafe and had spent a significant amount of money fitting out the premises. The tenant provided a bank guarantee of $27,500 to secure the performance under the lease. The tenant frequently paid rent late but generally paid the rent within 14-days of the due date. After the first year of the term, the tenant asked the landlord if the 50% rent reduction could continue for a further two months, that is for June and July 2017 and for the discounted amount to be 'amortised back at a later stage in the lease' due to trading difficulties. The landlord agreed to the tenant's request.

Consequently, the tenant only paid the agreed discounted rent for the months of June and July 2017.

On 3 September 2017, the landlord issued a tax invoice for the September rent as well as for the 50% discount that was provided in June and July.

On 6 September 2017, the tenant contacted the landlord to query the invoice, as the tenant was of the view that the amortised amount was to be paid at some later date. There were emails between the parties, but no agreement was reached as to when the amortised amount was to be paid.

On 13 September 2017, the landlord sent an email to the tenant stating:
'I am writing to inform you that you are now in breach of the lease. As at 3:45(pm) today, rent is still unpaid.'

The September rent remained outstanding.

On 17 September 2017, 17 days after the due date, the landlord changed the locks, terminated the lease and re-took possession of the premises. On 18 September 2017, the tenant paid all arrears to the landlord and sought the landlord's permission to re-enter.

The landlord said that the tenant could re-enter the premises only on certain conditions, one of which was that the bank guarantee would increase. The tenant would not agree to these conditions. The tenant proceeded to lodged an application with NCAT seeking $300,000 in damages and relief against forfeiture. The tenant lodged a second application related to the purported sale by the Landlord of the business fit out and rental equipment. At the first directions hearing, the Landlord advised that they were no longer seeking to sell these assets and this claim was withdrawn. On 12 January 2018, the landlord lodged a cross application claiming damages for loss and expenses for breach of the lease by the tenant.

In March 2018, the landlord entered into a new lease with a new tenant. Consequently, on 30 April 2018, the tenant amended its second application to no longer seek relief for forfeiture, and instead claim damages for wrongful termination of lease.

As stated in [3] of the judgement of the Appeal Panel:
'the case turned on the question of whether the lessor had lawfully entered the premises and taken possession of them.'

The landlord argued that they were entitled to take possession without written notice, pursuant to Clause 12.2 of the lease. In the alternative, they argued that their email of 13 September 2017, constituted sufficient written notice.

The tenant argued that where there had been non-payment of rent, Clause 12.2 required the landlord to provide at least 14 days written notice of the landlord's intention to end the lease and re-enter into the premises.

The lease was based on the Law Society retail lease.

Clause 12.2 of the lease states:
"The lessor can enter and take possession of the property or demand possession of the property if –

12.1.1 The lessee has repudiated the lease; or

12.2.2 rent or any money due under the lease is 14 days overdue for payment; or

12.2.3 The lessee has failed to comply with the lessor's notice under Section 129 of the *Conveyancing Act 1999*; or

12.2.4 The lessee has not complied with any term of this lease where a lessor's notice is not required under Section 129 *Conveyancing Act 1999*, and the lessor has given at least 14 days written notice of the lessor's intention to end this lease.

Section 129(10) *Conveyancing Act* states:
"This section applies to leases made either before or after the commencement of this Act, and *shall have effect notwithstanding any stipulation to the contrary*. "(emphasis added)

At first instance, the Tribunal took the view that Clause 12.2.4 is a clause that doesn't comply with Section 129(10) *Conveyancing Act* in that the clause has the intention of "circumventing" provisions of Section 129(8).

The Tribunal said that Clause 14.3 provides that the lease is subject to any legislation, which cannot be excluded. Thus, the Tribunal, at first instance, held that Section 129(8) *Conveyancing Act* cannot be excluded by virtue of Section 129(10). Therefore, Clause 12.2.4 is rendered inoperable and Senior Member Bluth held that the landlord was entitled to re-enter and take possession without notice to the tenant.

The Tribunal at first instance made the following orders:

1. Clause 12.2.4 of the Law Society Commercial Lease is contrary to Section 129(10) of the *Conveyancing Act* (whilst the judgement refers to "Commercial" lease – the relevant clause is identical in both the law society retail and commercial lease);

2. The tenant's claim is dismissed;

3. The tenant is to pay the landlord the sum of $50,294.20;

4. The tenant is to pay the landlord costs.

The first instance decision would have created serious concerns for tenants as it would have meant that despite the lease requiring notice to be served, such provision rendered inoperative. In my respectful opinion, it would have created significant confusion and does not accord with legislative intention of Section 129(10) which is commonly understood to mean that Section 129(1) should not be able to be excluded, not Section 129(8).

The Panel Appeal overturned the decision on this point.

At [23], the Appeal Panel stated:
"There was nothing in Section 129 *Conveyancing Act* which prevents the operation of the term of a lease, the subject matter of which is the re-entry or relief against forfeiture against non-payment of rent … This leaves the parties to a lease free to make their own agreement with respect to notice in relation to those circumstances."

That is, if the lease requires notice to be given for non-payment of rent, it must be given and such provision is not defeated by Section 129 *Conveyancing Act.*

Thus, the Appeal Panel reversed the decision by holding that Clause 12.2.2 was not affected by Section 129 *Conveyancing Act*.

However the Appeal Panel went on to consider Clause 12.2 in its entirely.

The landlord argued that each of the subclauses in Clause 12.2 are alternatives and that Clause 12.2.2 stands alone such that the lessor can enter and take possession if the rent is 14 days overdue. The Appeal Panel agreed. Thus, if a lease requires notice to be given then the landlord must give written notice, otherwise the tenant is entitled to relief. However, the drafting of the Law Society retail lease is such that Clause 12.2.2 stands alone and in this case because the rent was 14 days in arrears, the landlord could terminate and re-enter, despite Clause 12.2.4, as each of the 4 subclauses were alternative provisions – Clause 12.2.2 was not subject to Clause 12.2.4.

The Appeal Panel held at [34]:

"We consider that each of the sub-paragraphs of Clause 12.2 is intended to operate separately from each other." Despite the fact that the Appeal Panel overturned the concern, the tenant was unsuccessful in its claim because the landlord could rely on Clause 12.2.2 which did not require the service of a notice and this was independent to Clause 12.2.4.

I note in passing that whilst the Appeal Panel did not have to consider the argument about whether the landlord's email dated 13 September 2017 constituted written notice, they did state at [36] that they did not consider the email to constitute written notice of the landlord's intention to end the Lease.

Practice Notes

1. If using the Law Society retail or commercial lease, consider if you want the landlord to be required to give notice prior to terminating the lease for non-payment of rent. If you do, an amendment to the lease should be made such that at the end of Clause 12.2.2 please add "and the lessor has given at least 14 days written notice of the lessor's intention to terminate this lease."

2. Whilst the Appeal Panel decision clarifies that Section 129 will not override a lease provision requiring notice prior to termination for non-payment of rent, in this particular case, the tenant was left without a remedy. The tenant's business came to an abrupt end on 17 September 2017 because the parties were emailing each other regarding how the rent reduction for June and July were to be dealt with. In effect, the tenant was 17 days in arrears with the consequence that it lost its business.

3. Was the Landlord disadvantaged? It is noted in [8] of the judgement that the rent arrears were paid in full on 18 September 2017. In my view, the Appeal Panel correctly interpreted the Law Society lease however the tenant still failed for non-payment of rent for a period of 17 days. The concern is that the Law Society lease is for general use and I submit that, up until this decision, the general understanding would have been that because of Clause 12.2.4, notice was required to be given for non-payment of rent. It may be appropriate that the provision be redrafted or the notes for its use, should identify this concern.

4. If the tenant had paid the September rent and only withheld the amount in dispute, I assume that there may have been sufficient ambiguity such that the tenant would not have been in breach. Consider if in such circumstances it would have been prudent for the tenant to pay the September rent and pay the disputed amount into trust.

5. The case raises the difficulty for a party involved in litigation. In this case the tenant had to fund both the proceedings at first instance and the appeal, and whilst the appeal clarified the legal position, the tenant was ultimately unsuccessful.

6. It is not disclosed in the Appeal Panel judgment whether or not relief against forfeiture proceedings were commenced on an urgent basis. If they were not, it is suggested that the concerns could have been rectified by seeking relief against forfeiture at the same time as the initial application was lodged.

If acting for tenant what do you do if a tenant is locked out

1. If the tenant is locked out for breach of lease the first response is to negotiation with the landlord to have such that the tenant will rectify its breach and the landlord will re-instate the lease.

2. If the lease is terminated for non-payment of rent and your client wishes to pay the rent, it is important that the condition of the payment is that the lease be reinstated otherwise the landlord can simply take the payment of rent and not reinstate the lease at all.

3. If the landlord will not agree with in a relatively short space of time to reinstate the lease, you should file an urgent application with NCAT for relief against forfeiture if it is a retail lease or make application to the Supreme Court for relief against forfeiture if it is a commercial lease.

4. Typically, whilst the relief against forfeiture is a discretionary remedy the Court or Tribunal usually require the tenant to rectify the breach so in the case of rent pay the arrears in rent and pay the landlord's legal costs and other costs associated with terminating the lease, including locksmiths costs, etc.

5. It is noted that whilst a dispute should not be subject to proceedings until receipt of a certificate of failed Mediation from the Registrar, that is mediation is required prior to commencing proceedings, this prerequisite is not required in relation to urgent orders.

6. If you do file urgent orders in NCAT, remember that you are also required to file an ordinary application with your application for urgent orders. These applications must be filed together.

7. In very urgent cases, please consider telephoning the Tribunal as sometimes orders can be made in chambers

8. It will be necessary to adduce evidence and also to show capacity to pay.

9. In cases for relief against forfeiture it is imperative that a party acts quickly. This is important as it is a factor for consideration by the Tribunal, the Court and also if the business is closed and your client is no longer able to produce revenue, very quickly this can cause extreme financial hardship for the tenant and can in some circumstances mean liquidation.

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