Property update

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Variation of Leases – Tips and Traps

The Legal Background / What's the fuss about / a legal fiction?

Against a background of the High Court's imprimatur of the contractualisation of leases, a lease variation agreed by the parties could be viewed simply as a variation of contract.

However, as stated in Halsbury's "at common law an agreement to vary the terms of the lease was characterised, depending upon the circumstances, as either a collateral personnel agreement between the parties, or as a surrender of the existing lease and entry into a new lease which incorporated the terms as varied". [1]

In an English decision in 1970, Russell LJ for the Court of Appeal said:

> "The "surrender of by operation of law" takes effect whether or not the parties to the new lease intend it to take effect. Moreover, even if there is no express grant of a new lease the old lease will be surrendered by operation of law if the arrangements made between the landlord and the tenant are such as can only be carried out so as to achieve the result which they have in mind if a new tenancy is in fact created".[2]

The rule was derived from estoppel principles and the parties' intention was considered irrelevant.

In a 1991 English decision the court said:

> "The lessee [was] estopped from disputing the validity of the new lease to which he had agreed, and from denying that he had surrendered the old lease. The rationale is that the landlord cannot have validly granted the new lease without having first procured a surrender of the old one. The rule does not depend upon the actual intention of the parties, but upon the impossibility of the two demises co-existing".[3]

But even as far back as 1970 there was some disquiet about the rule. In the same case I referred to earlier Russell LJ considered a situation where parties to an existing lease wished to increase the rent without altering the land and he said:

> "Viewing the matter apart from authority, it is difficult to see why the fiction of a new lease and a surrender by operation of law should be necessary in this case; for by simply increasing the amount of rent, and providing the additional rent shall be annexed to the reversion one is not altering the nature of the pre-existing item of property. Further, if one looks to convenience, it would be most unfortunate if in these days, when arrangements

[1] Halsbury's Laws of Australia – 245 Leases and Tenancies, "Variation of Lease Terms" [245-1620] at 7/3/2016.
[2] Jenkin R Lewis & Son Ltd v. Kerman [1970] 3 All E.R. 414 at 419.
[3] Capolingua v Phylum Pty Ltd (1991) 5 WAR 137.

> for increase of rent are so common that the increase should be taken to involve of necessity a legal fiction which, although in most cases it may do no harm, may in some cases have serious repercussions."

In this paper I will look at some of the repercussions of this surrender principle after examining what types of variations might constitute a surrender and re-grant and what types may not.

TYPES OF VARIATIONS AND WHETHER OR NOT THEY MIGHT CONSTITUTE A SURRENDER AND RE-GRANT

A main issue is whether the variation is so substantial, or deals with particular topics so that it will be deemed a surrender by operation of law of the existing lease and a new lease creation.

- Variation of rent
  A number of cases have established that where the rent is reduced it could be seen as a voluntary forbearance, or as the grant and acceptance of a new demise. [4]

  Whether this "surrender principle" applies may depend on the effect of the alteration.

  If a rent review clause is included in a lease, there is no alteration to the terms of the lease and so if the rent is reviewed under the clause, the surrender principle cannot apply.

- Correction of Errors or Omissions
  A variation to correct an error or omission in the lease, will be a supplementary agreement only although material deleted by the supplementary agreement may be used to construe the remaining parts of the lease. [5]

- Term of Lease
  An alteration of the duration of the lease, by increasing the lease term or adding further options for renewal, is contentious but cases establish that either will affect a surrender of the original lease and the re-grant of a new lease.

- In a 1960 decision a supplemental deed extended a lease for 7 years to a lease for 11 years and the surrender principle was held to apply. And in a 1989 decision involving the inclusion of an option for renewal for a further term a Commissioner said:
  > "In my opinion, a demise with a covenant of renewal is an estate or interest in the land that is different from a demise containing no covenant of renewal, and this is so regardless of whether the covenant of renewal is in a form which provides for the enlargement of the existing term, or is in a form which provides for the grant of a new lease. I would therefore hold that the introduction into a lease by a deed of variation of an option of renewal works a surrender of the old lease by operation of law and a grant of new lease."[6]

- So as stated in Halsbury, "where the term of the lease is altered it is difficult to satisfy the court that there has been a mere variation."[7]
- The duration of the lease may be reduced but this will effect a surrender.[8]

A CHANGE TO THE LEASED PREMISES

As Lang has pointed out there are 3 possible changes:

(1) An addition to the existing premises;

(2) A reduction of the existing premises;

(3) Substitution of an entirely different premises, like on a relocation of a tenant within a shopping centre. [9]

The Redfern and Cassidy text [10] says the position with (1) is not clear, while Lang says **generally** (1) and (3) involve the surrender principle.

As to (2), in Penny v Craber [11], the leased premises were reduced (although only the grounds around the leased dwelling) and this was held not to be a surrender by operation of law. And in Jenkin R Lewis & Son Ltd v Kerman[12] the leased premises (and rent) were reduced without constituting a surrender.

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[4] See the cases referred to in "Commercial Tenancy Law", Bradbrook, Croft & Hay, 3rd Edition, page 510. Note the forbearance doesn't alter the terms of the lease and also see Central London Property Trust Ltd v High Trees House Ltd [1956] 1 ALL ER 256.
[5] Centrepoint Custodians Pty Ltd v Lidgerwood Investments Pty Ltd [1990] VR 411.
[6] O F Gamble Pty Ltd v Whitemore Pty Ltd (1989) 2 WAR 327.
[7] See Halsbury above.
[8] Tabcorp Holdings Ltd v Bowen Investments Pty Ltd (2009) 236 CLR 272.
[9] "Lang's Commercial Leasing in Australia" para 17-020.
[10] "Australian Tenancy Practice and Precedents" [13 05].
[11] (1967) 1 NSWR 683.
[12] Referred to above – see footnote 2.

So the safest course would seem to be that any addition to the area of the premises will bring in the surrender principle.

OTHER CHANGES AND CHANGES TO COVENANTS

It has been accepted that an assignment can alter the identity of the parties and therefore the surrender principle doesn't apply.

In the Happy Century Pty Ltd v Nezville Pty Ltd decision [13] a landlord purported by re-entry to forfeit a lease, and in the subsequent VCAT proceedings a deed of settlement was entered into which restored the lease and varied its terms. This was treated as a mere variation of the lease without a surrender because the Deputy President found, at paragraph 31:

> "Had the parties intended that there be a step as significant as a surrender and re-grant, it would seem likely that they would have provided for a separate deed to give effect to that intention as well, rather than have it effected or purportedly effected by a clause in terms of settlement executed only by counsel."

The Deputy President placed reliance on the fact that there was no variation to the term of the lease and that a provision making Happy Century Pty Ltd provide an additional security deposit by way of bank guarantee, when viewed against the totality of the obligations constituted by the lease, was "relatively trivial".

In a recent situation in which a client landlord of mine was involved, a tenant had, without the landlord's consent or knowledge, applied for and obtained a liquor licence for the premises. I took the view that the lease needed to be amended by including provisions to deal with that. I treated the matter as involving the surrender principle.

Other issues which practitioners may need to consider include agreements about removal of fixtures, internal alterations of works, adding a guarantor or bank guarantee or security deposit provision or altering them on a transfer of lease.

Also, and very current after Justice Garde's VCAT's opinion, practitioners might need to consider the position if a lease is amended to make clear the landlord's and the tenant's responsibilities for essential safety measures.

So as a general overview, some variations can be made without invoking the surrender principle, and it has been suggested that if the variations are minor "it may be inferred that the parties did not intend a surrender. In other cases, the alterations may be so numerous or fundamental that an intention to surrender and regrant will be inferred. For surrender to occur in these circumstances it would not be necessary for other parties to appreciate the effect of the transaction; it would suffice that they intended to create a new relationship".[14]

Why is this important?

If a new lease is created by a variation it may then become a retail premises lease, whereas the prior lease may not have been.

Practitioners should consider carefully the position where a lease is not subject to the Retail Leases Act, either because when it commenced a tenant was a public company or a subsidiary of a public company, or the lease was for more than a 15 year term. If a variation of lease is entered into when the tenant at the time is other than a public company, and the balance remaining in the term is less than 15 years, the lease may well become a retail premises lease.

If so, the rights and entitlements of landlord and tenant will necessarily be altered. The tenant's position will be substantially improved. Among other things, the tenant will not have to pay land tax and will have the benefit of the landlord covenants in section 52 of the Retail Leases Act requiring the landlord to maintain the structure of, fixtures in and the plant and equipment at, the premises in a condition consistent with the condition of the premises when the lease was entered into.

As well the landlord must provide the tenant with a new disclosure statement. The Small Business Commissioner in a guide has confirmed that a new disclosure statement is required when a retail premises lease is varied.[15] If the landlord does not so provide a disclosure statement then under section 17 of the Retail Leases Act, the tenant, no earlier than 7 days and no later than 90 days after entering into the lease, can give the landlord written notice that the tenant has not been given the disclosure statement. If the tenant gives the notice, then the tenant may withhold payment of rent until given the disclosure statement; is not liable to pay rent for that period and can give a notice of termination "at any time before the end of 7 days after the landlord gives the tenant a disclosure statement".

[13] (2000) V ConvR 58-546.
[14] See footnote 12 above.
[15] See www.vsbc.vic.gov.au/faq.

REGISTERED LEASES

In Victoria following an amendment to the Transfer of Land Act in 2014, a registered lease can be varied by a registrable instrument in an approved form.

But in Victoria amendments cannot be made to the parties, or the term or the area of the registered lease.[16]

It follows that if a new area is to be added, a new registered lease must be entered into. If the area is to be reduced then a partial surrender of the existing lease must be lodged.

Alternatively if the variation is not to be registered, a caveat can be lodged to give notice of it.

POSITION OF A MORTGAGEE UPON VARIATION OF A REGISTERED LEASE

Now in Victoria by an amendment made to the Transfer of Land Act inserting section 87C, which became effective on 24 September 2014, if a registered mortgagee does not consent to the variation of a lease, that lease variation is not binding on the registered mortgagee or annuitant.[17]

So a landlord and tenant must obtain a mortgagee's consent to any lease or variation of a lease, whether or not it is to be registered.

If the landlord doesn't do so it will almost certainly be in breach of its mortgage.

If a lease which is granted while the premises are unencumbered is then surrendered and a new lease entered into, after the landlord has granted a mortgage, the mortgagee will not be bound by that new lease. So the new lease will only be enforceable by the parties to it in equity.

The celebrated case of the Commonwealth Bank of Australia v Figgins Holdings[18] is a very good illustration of a mortgagee not being bound by a variation of a lease by the landlord and tenant (in that case varying the rent to $1.00) when the mortgagor/landlord was in default under the mortgage.

While a mortgagee can now rely on section 87C, Lang at paragraph 17-050 suggests a mortgagee should:

(1) "Include mortgage covenants prohibiting variation in lease terms during the continuance of the mortgage without the mortgagee's consent; and

(2) Add in any consent to a lease by the mortgagee that the consent is to the lease in that form and reiterating that the mortgagee's consent is required to any subsequent variation of the lease."[19]

GUARANTORS

Despite a clause in a deed of guarantee that the guarantor of a lease will be bound by any variation to the lease, it would be prudent to have the guarantor acknowledge their continuing guarantee of the obligations of the tenant as so varied.

POSITION OF AN ASSIGNOR AS "GUARANTOR" OF THE ASSIGNEE'S PAYMENT OF RENT AND OBSERVATION OF THE LEASE COVENANTS

If a variation of a lease is made by an assignee of a lease (new tenant) and the landlord, and is so significant that the surrender principle applies, the landlord may lose any rights to sue the assignor (former tenant) unless the assignor (former tenant) has consented.[20]

Practitioners also need to be very careful when dealing with a transfer of lease which also includes variations and to consider whether those variations are of sufficient significance or detail to attract application of the surrender principle. I note the Law Institute of Victoria form of Transfer of Lease does cater for variations of a lease at the same time as a transfer takes place.

THE FORM OF VARIATION OF A LEASE

A lease, even if made by deed, may be varied by an agreement which is not a deed[21] but prudence says it should be, and any mortgagee's consent obtained either as a party to the deed or in a separate instrument. The same applies to all interests registered before the variation.

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16 Section 67A of the Transfer of Land Act.
17 Section 87C of the Transfer of Land Act.
18 (1994) ANZ Conv R 633.
19 Lang paragraph 17-050.
20 See CPT Custodian Pty Ltd v Ironbark Hills Pty Ltd [2011] QDC 4 where an extension of the term released the assignor from rent payments when the assignee defaulted.
21 Plymouth Corporation v Harvey (1971) 1 ALL ER 623 at 627.

The variation should include a provision binding and benefitting successors and assigns of the landlord and the tenant.

This is particularly important given the protection provided by section 42(2)(e) of the Transfer of Land Act.

The variation should also be expressed as supplemental to the lease so as to pick up section 58 of the Property Law Act 1958 which is as follows:

Provisions as to supplemental instruments

> "Any instrument (whether executed before or after the commencement of this Act) expressed to be supplemental to a previous instrument, shall, as far as may be, be read and have effect as if the supplemental instrument contained a full recital of the previous instrument, but this section shall not of itself operate to give any right to an abstract or production of any such previous instrument, and a purchaser may accept the same evidence that the previous instrument does not affect the title as if it had merely been mentioned in the supplemental instrument."

The wording of the variation is extremely important. This is illustrated by the Price Brent case[22] noted by Lang as follows:

> "A firm of solicitors leased three floors of an office building in Melbourne. Under the lease, the lessee was required to pay a share of the lessor's operating expenses for each year of the lease. The parties agreed to cut short the 5 year lease term by 7 months and entered into a variation of lease to give effect to that agreement. The variation operated from 30 June 1992 and said the lessee was to pay "the sum of $64,479 as a final contribution to outgoings (final outgoing contribution).
>
> The lessee had not paid its share of the outgoings for the year ending January 1992. The lessor sought payment of those accrued outgoings in addition to the sum of $64,479 which it said was solely for the outgoings that, but for the variation, would have been payable in the last 7 months of the lease. The lessor's contentions were dismissed. It was held that, although accrued liabilities under a lease are not generally extinguished on a surrender, the phrase "final outgoings contribution" in the variation of lease was intended to cover not only future outgoings, but past outgoings also."[23]

Precedents for variations are to be found in Lang and Redfern and Cassidy[24]

A RECENT DECISION ILLUSTRATING WHY THE SURRENDER PRINCIPLE IS IMPORTANT

In Richmond Football Club Limited v Verraty Pty Ltd [2011] VCAT 2104 a lease was entered into prior to the introduction of the Retail Leases Act in 2003. But in 2004 a variation was made making significant change to that lease. The changes included reducing the rent, amending the rent review and bank guarantee provisions, introducing an obligation to pay GST and, importantly, extending the term of the lease by 10 years to 18 May 2018.

The senior member of VCAT held that, after referring to Halsbury, the evidence disclosed the parties intended to change the leasing arrangements between them. The member held that the substantial changes to the original lease operated at law to effect a surrender and a re-grant on substantially the same terms as the original lease as amended by the 2004 variation.

The significance of this was that the lease then became subject to the Retail Leases Act 2003 and accordingly the Richmond Football Club was able to obtain an order for repayment of land tax that it had paid under a mistake and contrary to section 50 of the Retail Leases Act. The member also referred to section 94 of the Retail Leases Act which he said operated to include provisions in the agreement.

The case is recommended reading for lawyers in this area because the Counsel acting for the landlord raised just about every possible defence that could be raised to the football club's claim. The defences included estoppel (because the RFC had not sought to enforce new rights arising under the Retail Leases Act until December 2009 being more than 6 years after the 2004 variation.

The member examined whether estoppel by convention would apply. The member observed that where a transaction was found to be invalid for non-compliance with the provisions of the Retail Leases Act, that non-compliance cannot be circumvented by reliance upon the doctrine of promissory estoppel. At paragraph 53 the member did not accept that RFC was estopped from relying upon the provisions in the Retail Leases Act. He did not find on the facts that RFC represented that it would not so rely. He considered that section 94 operated to negate a defence based on promissory estoppel, in circumstances where nothing more is done than execute a document which, on its face, contains provisions which are contrary to the Retail Leases Act.

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[22] National Mutual Life Association of Australia Ltd v Price Brent Services & Ors. [1995] VSC 277 (unreported).
[23] Lang paragraph 17-100.
[24] See footnotes 9 and 10 above.

Fortunately for the RFC the "re-granted lease" was for a term of less than 15 years and so a further defence raised by Counsel acting for the landlord that Ministerial Order S184 (which says certain leases for more than 15 years are not retail premises leases) applied to the circumstances was dismissed.

The landlord's Counsel then raised unconscionable conduct and suggested there was good consideration for the payments and relied upon the Dog Depot decision[25] to elaborate on the latter point. Counsel submitted that the landlord was entitled to compensation for lost land tax under a counter-restitutionary claim for use and occupation. The member said however that it couldn't be said that RFC has been unjustly enriched by not having to pay the landlord's land tax in circumstances where it never had an obligation to do so.

The last line of defence raised by the landlord's Counsel was that the action brought by RFC, or at least part of it, was statute barred and he referred to the Limitation of Actions Act 1958. Here Counsel was successful and the claim for money the landlord had received was statute barred insofar as it related to the first payment of land tax made on 1 April 2004 when the proceeding was filed in the Tribunal on 29 October 2010. The final order was that the landlord was obliged to repay RFC $125,320 being money the landlord had received for land tax mistakenly paid after 29 October 2004.

A DRAFTING SUGGESTION

A possible way to address the issue may be to include wording like the following in a lease:

"If there is a variation of this lease the lease continues and the variation does not constitute a surrender of this lease and a regrant of a new lease."

However, the concentration by the Senior VCAT Member in the RFC case referred to above on the intention of the parties perhaps means this clause may assist a defence argument that a variation should not be treated as a surrender and regrant.

Further, to assist with an estoppel argument, perhaps a further warranty or covenant by a tenant that it agrees that any variation of the lease will not be a surrender of the lease and a regrant of a new lease could also be included.

However if there are significant variations to a lease, like an extension of the term or an addition to the area of the premises, the nature of those variations may mean a court or tribunal would have difficulty in finding that the intention of the parties was not to surrender the lease and enter into a new lease, despite the warranty or a covenant.

So no guarantee is given by the author that the suggested wording above will be successful in subsequent proceedings.

REFERENCES

- Bradbrook, Croft & Hay, "Commercial Tenancy Law" 3rd Edition.
- "Lang's Commercial Leasing in Australia".
- Redfern & Cassidy "Australian Tenancy Practice & Precedents".
- WD Duncan, "Commercial Leases in Australia" 6th Edition.
- Halsbury's Laws of Australia, paragraphs 245-1620 and following.
- "Leases and Mortgages – A Guide to Contemporary Issues in Property Law", Leo Cusson Institute November 1997, Chapter 6 "The Protection of Leases in Victoria" at page 177 and following.

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[25] Dog Depot Pty Ltd v. Ovidio Carrideo Nominees Pty Ltd [2003] VCAT 1990.

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