LEASE TERMINATION ISSUES

Peter Nugent, Special Counsel

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1. Why terminate?

1.1 Practical considerations for the Landlord

In the event of a breach sufficient to trigger a lease termination, the Landlord may elect to terminate; or to allow the lease to continue and, if desired, to seek an alternative remedy for the breach.

Once the lease is terminated the landlord is entitled to claim damages for existing breaches and, depending on the circumstances may be entitled to claim damages for the lost future rent and for reletting costs. However, the landlord is then obliged to mitigate those damages.

However, the mere fact of a fundamental breach or repudiation by the Tenant does not oblige the Landlord to bring the lease to an end.\(^1\)

1.2 Are damages available for loss of future rent

The general assumption is that a landlord who has terminated for breach is entitled to damages to compensate for the loss of future rent and the costs of reletting the premises. However, at common law, damages for loss of the bargain will only apply where the termination follows the repudiation or fundamental breach of the tenant.

In *Shevill v Builders Licensing Board*\(^2\), the landlord exercised a right to terminate because of arrears of rent. The termination was valid and the case concerned whether the landlord was able to claim damages for lost future rent. The High Court held that the obligation to pay rent was not an essential term of the lease and the tenant’s extensive record of arrears did not amount to a repudiation of the lease. Accordingly, the landlord could not claim damages for the loss of a bargain it had brought to an end. *Shevill* is the reason that leases commonly include:

(a) provisions declaring rent payment and various other obligations to be essential terms;

(b) an indemnity requiring the tenant to compensate the landlord for loss of bargain where the landlord has exercised a right to terminate the lease.

In *Gumland Property Holdings Pty Limited v Duffy Bros Fruit Market (Campbelltown) Pty Limited*\(^3\) the High Court upheld a claim for loss of bargain damages because the lease contained extensive provisions making it clear that remedy was to apply.

1.3 Relevant considerations for the landlord

A landlord may prefer to keep the lease on foot where the likelihood of a replacement tenant is low and:

(a) there is some doubt about the availability of loss of bargain damages, or the tenant’s capacity to pay those damages;

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\(^1\) See for example *J and S Chan Pty Limited v Victor Geoffrey McKenzie and Lynette Anne McKenzie* [1994] ACTSC 1 applying the principle stated in *White and Carter (Councils) Ltd v McGregor* [1962] 2 AC 413

\(^2\) (1982)149 CLR 620

\(^3\) [2008] HCA 10
(c) keeping the premises occupied is nevertheless a benefit to other tenants, such as in a shopping centre.

If there is no real question about the likelihood of loss of bargain damages then the landlord will often be better off promptly taking the opportunity to bring an unsatisfactory tenancy to an end. Delaying while defaults pile up or stretch out has risks: the landlord’s behaviour might start to look like a waiver or result in an estoppel, the tenant may flop over the line remediating the breach.

2. **Landlord’s right to terminate**

2.1 **Contractual rights**

It is clear from *Shevill’s* case and other decisions that a lease is a contract and, subject to its terms, may be terminated on the same basis as any other contract, namely:

(a) by the acceptance of the tenant’s repudiation;

(d) as a result of the breach of an essential or fundamental term; and

(e) under a right stated in the contract.

2.2 **Common lease provisions**

Leases commonly include rights for a landlord to terminate where:

(a) the tenant is in breach or there are acts or indications of insolvency;

(f) a frustrating event occurs, such as the destruction of the building;

(g) the landlord wants to demolish or redevelop.

2.3 **Statutory rights**

Section 107 of the *Property Law Act 1974* implies into leases (unless excluded), a right for the landlord to terminate the lease where rent is in arrears for 1 month or for breach of another obligation that continues for 2 months (or a period specified in the lease for the breach of a repair covenant).

Section 107 is a right implied into the lease. The *Retail Shop Leases Act 1994* also gives tenant’s rights to terminate in certain circumstances.

3. **Procedural preconditions to termination for breach**

3.1 **Section 124 of the *Property Law Act 1974***

"124 Restriction on and relief against forfeiture

(1) A right of re-entry or forfeiture under any proviso or stipulation in a lease, for a breach of any covenant, obligation, condition or agreement (express or implied) in the lease, shall not be enforceable by action or otherwise unless and until the lessor serves on the lessee a notice—

(a) specifying the particular breach complained of; and

(b) if the breach is capable of remedy, requiring the lessee to remedy the breach; and
(c) in case the lessor claims compensation in money for the breach, requiring the lessee to pay the same;

and the lessee fails within a reasonable time after service of the notice to remedy the breach, if it is capable of remedy, and, where compensation in money is required, to pay reasonable compensation to the satisfaction of the lessor for the breach.”

3.2 When does section 124 apply

The section applies to a right of re-entry or forfeiture in the lease for a breach of the lease.

A notice is not required if the landlord is electing to accept the tenant’s repudiation of the lease as that is a common law right⁴. It might be otherwise if the termination clause in the lease refers to repudiation of the lease as a ground of termination.

A notice is not required where the right to terminate is not the result of a breach. For example, where the tenant is insolvent but continues to perform the lease obligations.

Gibbs CJ in Shevill

“The other conditions on which re-entry is available do not necessarily involve a breach of any covenant or condition of the lease. In some cases, whether or not there has been a breach, the right of re-entry given by cl. 9(a) may become available although the circumstances would not suggest that the position of the lessor under the lease has been substantially affected or threatened. For example, a lessee … may make an arrangement with his creditors the effect of which will nevertheless be that he can continue to pay the rent fully and on time. In all these circumstances the lessor is given the right to re-enter.”⁵

3.3 Other issues about section 124

(a) The notice must be given in a particular form (copy attached) and a failure to comply with the form requirements can be fatal⁶.

(h) The section says that the notice need only require the remedy of breaches that are capable of being remedied, but the form 7 does not contain that option.

(i) The prescribed form suggests that a remedy period should be stated, but that does not appear to be a mandatory requirement and the CCH Conveyancing Law Commentary suggests it would be better practice to state in the notice only that performance is required within a reasonable time.

(j) There is also a right to terminate if the landlord includes in the form 7 a claim for compensation for the breach and the tenant fails to pay reasonable compensation to the satisfaction of the landlord.

(k) Section 124 acts as a stay on the right to terminate until the tenant fails to remedy the breach, if it can be remedied, within a reasonably time after service of the notice.

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⁴ CMA Recycling Victoria Pty Ltd v Doubt Free Investments Pty Ltd [2011] TASSC 71
⁵ At 629
⁶ See Nashvying P/L & Ors v Giacomi [2007] QCA 454
(I) If the lease has been assigned the notice need only be served on the current tenant, even if the assignor remains liable for a breach of the lease\(^7\).

### 3.4 Breaches that cannot be remedied

This is a question that is somewhat uncertain. Muir J in *Nashvying P/L & Ors v Giacomi\(^8\)* reviews various authorities distinguishing between negative covenants, such as not to assign, and positive covenants, such as to keep in repair. The sensible conclusion his Honour reaches is that:

(a) the proper test is whether the breach can be completely undone, but whether it can be set right for the future, so a covenant not to part with possession can be set right by regaining possession\(^9\); and

(b) the detriment caused by the breach must be one that is capable of being remedied within the reasonable time.

As a practical matter, the large majority of lease breaches will be capable of remedy.

### 3.5 A reasonable time

A reasonable time is the time that would be reasonably required to carry out the various actions required to remedy the breach. So in *Nashvying P/L & Ors v Giacomi*\(^10\), the reasonable time to acquire a mining licence and various development approvals was estimated at 69 weeks; and in *Makucha v Benmar Properties Pty Ltd*\(^11\) a notice requiring the tenant to obtain a rezoning in 3 months was considered to be unreasonably short.

It is suggested in CCH Queensland Conveyancing Law Commentary, on the basis of an old English case\(^12\) that between 2 and 14 days will be too short. However, in *BBF Toowoomba P/L v Nebrean P/L*\(^13\) 8 days was considered sufficient notice requiring trading to recommence.

As previously noted, it does not seem the case that a period of notice has to be specified in the form 7 and that it would be better to simply state that the breach must be remedied within a reasonable time, which is what occurred in the *Makucha* case.

If a period is specified and that period is unreasonable, does that invalidate the notice? In *Re Automotive & General Industries Ltd.’s Lease*\(^14\) it was held that a notice was not invalid because the period was too short (albeit only by one day) because the relevant section (which is a little different to section 124) did not require the period to be specified and a sufficient period had elapsed since service.

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\(^7\) *Chelfield Pty Ltd v Goldsea Pty Ltd* [2003] QSC 40  
\(^8\) [2007] QCA 454  
\(^9\) *Ace Property Holdings P/L v Australian Postal Corp* [2010] QCA 55  
\(^10\) [2007] QCA 454  
\(^11\) [1995] QCA 340  
\(^12\) *Horsey Estate Ltd v Steiger* (1899) 2 QB 79  
\(^13\) [2001] QSC 313  
\(^14\) [1970] VSC, 1 May 1970 and reported at (2012) V ConvR 54-801
Section 112 of the Property Law Act 1974 applies to breaches of repair covenants and includes a further notice requirement for a section 124 notice and makes it clear that the period allowed to remedy must be reasonably sufficient to make the repairs.

3.6 Claims for compensation

Section 124 also invites the landlord to claim a specified amount of compensation for the breach and allows termination if the tenant does not pay reasonable compensation to the satisfaction of the landlord. It takes only a moment’s thought to realise that a claim for compensation will only add uncertainty to the process, as that is yet another issue to be the subject of a dispute with the tenant.

4. Repudiation

4.1 What is repudiation

“A contract may be repudiated if one party renounces his liabilities under it - if he evinces an intention no longer to be bound by the contract (Freeth v. Burr (1874) LR 9 CP 208, at p 213 ) or shows that he intends to fulfil the contract only in a manner substantially inconsistent with his obligations and not in any other way (Ross T. Smyth & Co. Ltd. v. T. D. Bailey, Son & Co. (1940) 3 All ER 60, at p 72; Carr v. J. A. Beriman Pty. Ltd. (1953) 89 CLR 327, at p 351 ). In such a case the innocent party is entitled to accept the repudiation, thereby discharging himself from further performance, and sue for damages: Heyman v. Darwins Ltd. (1942) AC, at p 399.”

Persistently falling in arrears, as in Shevill’s case, did not amount to repudiation as the tenant was always trying to pay the rent and was never more than 2 months in arrears.

Acts that have amounted to repudiation include the following:

(a) refusing to pay rent from May to October was a repudiation when based on an erroneous claim about the lease terms;16

(b) failing to register a lease following a long delay and then a notice of demand from the tenant17;

(c) abandonment and failing to pay rent (and other breaches and indications of non-performance).18

However, the Courts will not lightly find repudiation by a tenant and it will be a rare case where actions short of abandonment amount to repudiation19.

Where the lease includes clear rights of termination that will usually be the safer route to termination.

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15 Gibbs CJ in Shevill’s case at 626
16 Progressive Mailing House Pty Ltd v Tabali Pty Ltd (1985) 157 CRK 17 see also Rikpa Pty Ltd v Maggiore Bakeries Pty Ltd (1984) VR 629 for a similar decision
17 Laurinda Pty Ltd v Capalaba Park Shopping Centre Pty Ltd (1989) 63 ALJR 372
18 Wood Factory Pty Ltd v Kiritos Pty Ltd [1985] 2 NSWLR 105 and Vuksic v Metimex (1995) V ConvR54-511
19 Mason J in Progressive Mailing House Pty Ltd v Tabali Pty Ltd, and see Keswick Developments Pty Ltd & Anor v Keswick Island Pty Ltd & Ors [2011] QCA 379
4.2 When is repudiation useful

The fact of repudiation is advantageous in the following circumstances:

(a) tenants are much less likely to have contractual rights to terminate for breach;
(b) if there is some uncertainty about the availability of loss of bargain damages;
(c) where there will be problems serving a notice under section 124.

For example, if a tenant has abandoned the premises and cannot be found, the right to accept the tenant’s repudiation of the lease may save the difficulty of applying for substituted service where the lease does not provide an easy method of service.

5. Methods of termination

5.1 Acceptance of repudiation

As is clear from Shevill’s case and Progressive Mailing House v Tabali, if a party to a lease repudiates the lease or breaches a fundamental term then the other party is entitled to accept that repudiation and bring the lease to an end.

5.2 Right to terminate under the lease

If termination rights for repudiation or breach of a fundamental term do not apply then the right to terminate must be contained in the lease, either as an express term or though statutory implication under section 107 of the Property Law Act 1974.

A key point is that the method of termination must be authorised in the lease. For example, in Rasheed v Burns Philp Trustee Co Ltd, a notice purporting to terminate the lease on a date 5 weeks from service of the notice was ineffective as the lease only authorised termination by re-entry.

5.3 Re-entry and forfeiture

The two main methods of forfeiting a lease are:

(a) physical re-entry; and
(b) the service of proceedings claiming possession.

In both cases the lease is immediately brought to an end, though given potential claims for relief, and the fact of the Court process in the second case, the effectiveness of the forfeiture may not be established for some time.

“There are, of course, curiosities in the status of a forfeited lease which is the subject of an application for relief against forfeiture. Until the application has been decided, it will not be known whether the lease will remain forfeited or whether it will be restored as if it had never been forfeited.”

20 (1982) NSW ConvR 55-102
21 Meadows v Clerical, Medical and General Life Assurance Society (1980) 1 ALL ER 545 at pp 457-790
5.4 Physical re-entry

Once the right to terminate has arisen a landlord is entitled to retake possession of the premises. This would most commonly be done by after-hours lock out. Though in *Ex parte Whelan* the landlord attended the premises with a locksmith and demanded possession, which the tenant refused to give and the landlord left the premises without securing physical possession, the Court held that the lease had still be effectively terminated\(^{22}\).

5.5 Termination by notice

If permitted under the lease, the service of a notice of termination will be an effective termination of the lease.

5.6 Surrender by operation of law

One form of surrender by operation of law occurs where a new lease is granted by the landlord after the premises have been abandoned\(^{23}\). There is some uncertainty as to whether a surrender by operation of law has the effect of limiting the landlord claim for loss of bargain damages against the previous tenant.

5.7 The power of attorney for surrender

Leases commonly include a power of attorney clause allowing the landlord to execute a surrender of the lease where the right to re-enter has arisen. Given the right of a landlord to register a termination of lease using a form 14 request, does this provision have any purpose?

The power of attorney clause is useful where the lease to be determined is subject to a sublease and the landlord wishes to preserve the sublease.

A determination of a lease results in the determination of any subleases unless the sublessee makes and succeeds in a claim for relief under section 125 of the *Property Law Act 1974*. However, a surrender is a conveyance of the lessee’s estate to the lessor and does not determine any subleases. Section 115 of the *Property Law Act* then applies to preserve the covenants in the sublease and the obligation to pay rent, but not any right to renew the sublease\(^{24}\).

6. Consequences

6.1 Damages

The landlord who elects to terminate is always entitled to damages for the breaches preceding termination, however, the land law principle is that following termination the landlord is only able to claim mesne profits for any period between termination and actual recovery of possession. Costs of reletting and damages for lost rent are only available under contract law and are not a traditional remedy under land law.

The landlord has a duty to mitigate the loss:

\(^{22}\) [1986] Qld R 500
\(^{23}\) *Spinks v Mundy* (1987) QSR 234
\(^{24}\) *Cihan v Oncu* [2004] NSWSC 338
“Clause 7.8 echoed the general law in obliging the Lessor to take reasonable steps to mitigate loss. The Lessor could not have got both damages (namely, the present value of the unpaid rent from the time of termination until the expiry of the Lease) and in addition any rent capable of being earned by a re-letting of the Demised Premises. The Lessor was only entitled to obtain, as damages, the present value of any difference between the rent not paid by the Lessee and the rent received or to be received on re-letting.”

6.2 Tenant’s fixtures and chattels

Subject to the express provisions in the lease, the general position will be:

(a) a tenant in possession can remove its chattels;

(b) if there is a termination by re-entry the tenant must be given a reasonable opportunity to remove its chattels from the premises;

(c) where the lease expires or terminates after a notice period, an abandonment provision is more likely to be enforceable against the tenant;

(d) the entitlement to remove tenant’s fixtures may be lost where the lease is surrendered, including a surrender by operation of law.

6.3 Incentive clawbacks and penalties

Lease incentives are common, are currently quite substantial, and are usually accompanied by clauses such as these:

Example 1

If the Lessee does not strictly comply with the terms of the Lease then the Lessee must pay to the Lessor on demand the full amount of the Incentive.

Example 2

The granting of the incentive in this Schedule 2 only remains in force while the Tenant is not in default under the Lease. In the event that the Tenant is in default under the Lease then the obligations upon the Landlord to pay the incentive as set out in this Schedule 2 shall immediately be at an end and no further rent reductions, contributions to fitout, works or any other incentive offered by the Landlord will apply.

Example 3

The Landlord and the Tenant acknowledge and agree that: whilst # is the Tenant under this Lease and the Tenant strictly complies with the terms of this Lease, the Rent payable during each year of the Lease will be reduced by $# per annum, such rent abatement to be applied in equal monthly instalments throughout each year of the Lease.

Example 4

1 Acknowledgement

25 Gumland Property Holdings Pty Limited v Duffy Bros Fruit Market (Campbelltown) Pty Limited [2008] HCA 10
Tenant Name Pty Ltd ACN 123 456 789 acknowledges that the Lease Incentive is personal to Tenant Name Pty Ltd ACN 123 456 789 and paid to Tenant Name Pty Ltd ACN 123 456 789 in consideration for Tenant Name Pty Ltd ACN 123 456 789 remaining in possession of the Premises under the Lease for the whole of the Term.

If the Lease ends before the Expiry Date due to the default of the Tenant, Tenant Name Pty Ltd ACN 123 456 789 must, within 14 days of the occurrence of that event, repay to the Landlord the whole of the Lease Incentive.

2 Balance Lease Incentive as Rent reduction

So long as the Tenant otherwise complies with the terms and conditions of the Lease, the Tenant may take the Balance Lease Incentive as a proportionate reduction in Rent payable each month during the Term of the Lease.

Before considering the legal issues with those clauses, it is worth first considering the role that incentives play in lease transactions.

A common incentive is the provision of fit-out (or its cash value) to an agreed amount. This helps the tenant get started in the new premises and the landlord gains a higher rent that, at least to some extent, reflects the greater value of the premises resulting from the fit-out incentive.

Also common is the rent holiday or reduced rent period and this will also help the tenant get established in the premises.

The third type of incentive tends to become more common during a recession and is illustrated in the third example above. Under this form of incentive the face rent is reduced in every year of the term. That particular lease had a large fit-out contribution and a large annual reduction in the face rent. Essentially, the true effective rent for the whole term is substantially less than that shown on the face of the lease.

The fourth example clause is seeking to make the incentive consideration for a separate promise to remain in occupation of the premises for the whole term. It is still difficult to see how the refund of the incentive payment relates to the damage the landlord suffers if the lease is terminated.

6.4 Are claw-backs penalties?

Ultimately this depends on the circumstances of each case, but some guidance can be obtained.

First, there are two basic situations that have to be considered:

1. the lease continues but the incentive is lost or has to be repaid; and

2. the lease is terminated and the lease provides for the refund of some or all of the incentive, as well as there being a liability to general damages for loss of the bargain.

Second, is a provision such as the second example clause capable of being a penalty? In that provision the ongoing compliance with the lease terms is a precondition to the availability of the incentive. This is somewhat similar to high and low interest rate provisions in loan agreements, where the high rate is stipulated as the
agreed interest, and the low rate will be accepted for prompt payments. Such provisions have traditionally not been regarded as penalties.

However, in *Legione v Hateley*\(^{26}\), Mason and Deane JJ had this to say:

“A penalty, as its name suggests, is in the nature of a punishment for non-observance of a contractual stipulation; it consists of the imposition of an additional or different liability upon breach of the contractual stipulation.”

The key question for that type of incentive claw-back is whether the primary liability is to pay the reduced rent or the pre-incentive rent.

One potentially distinguishing characteristic of the third example clause is that it is at least arguable that the benefit of the incentive is not lost because of a breach, but rather is available while the tenant complies with the lease. Such a clause seems to have been accepted in *Elsafty Enterprises Pty Ltd v Mermaids Café & Bar Pty Ltd*\(^{27}\), but the question of whether it was a penalty does not seem to have been raised. It seems that the rule against penalties will not be attracted when the payment or loss is not consequent upon a breach\(^{28}\).

Where the lost incentive is:

- a right to a payment; or
- a fit out contribution; or
- there is an obligation to repay a fitout contribution,

the potential for the operation of the rule against penalties is much clearer.

### 6.5 *Ringrow*

In *Ringrow Pty Ltd v BP Australia Pty Ltd* (2005) 224 CLR 656 the High Court, in a joint decision, gave detailed consideration of some of the rules relating to when obligations applying on breach would be a penalty.

That case concerned an option to buy-back a service station in the event of a breach of a fuel supply agreement. The question was whether the option was itself a penalty. The key point in the decision is that the obligation applying on the breach must be so disproportionate to the damage caused by the breach that the obligation is oppressive or unconscionable. The judgement contains a number of different formulations of this concept (quoting from other decisions):

*The starting point for the appellant was the following passage in Lord Dunedin's speech in Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*\(^{29}\):

> “2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage ...”

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\(^{26}\) (1983) 152 CLR 406 (at 445)

\(^{27}\) [2007] QSC 394

\(^{28}\) See the discussion in *Interstar Wholesale Finance Pty Limited v Integral Home Loans Pty Limited* [2008] NSWCA 310

\(^{29}\) [1915] AC 79 at 86-87
3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach ...

4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach ...

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid ...

(c) There is a presumption (but no more) that it is penalty when 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage'.

And quoting Mason and Wilson JJ in AMEV-UDC Finance Ltd v Austin:

a "degree of disproportion" sufficient to point to oppressiveness

an agreed sum should only be "characterized as a penalty if it is out of all proportion to damage likely to be suffered as a result of breach" "[E]quity and the common law have long maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory. The test to be applied in drawing that distinction is one of degree and will depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. The courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract." (emphasis added)

In AMEV-UDC Finance the majority of the Court held that a clause requiring payment of all future rent on termination of a chattel lease was a penalty because the resulting amount was wholly disproportionate to the loss suffered by the lessor.

If a lease provides that the ongoing benefit of the incentive is to be lost, or it is to be repaid if there is a breach, then there must be a real risk that the provision will be a penalty, especially where the incentive is large.

If a lease is terminated, then subject to mitigation obligations, the landlord will generally be entitled to claim damages for the loss of future rent as well as the other costs incurred, with interest applying. It is not difficult to see that an on-going shortfall in rent is a genuine loss to the landlord. However, once compensated on normal principles, the landlord essentially has the benefit of his or her bargain.

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30 (1986) 162 CLR 170
The bargain that the parties made includes the provision of the incentives, which is part of the consideration provided by the landlord and for which the tenant agrees to pay the rent and comply with the other lease obligations. If there is a rent discount for the term of the lease then the discounted amount is the rent the landlord agreed to receive for the use of the premises and the other benefits provided by the landlord. If the tenant is late with a rent payment then interest is the proper compensation.

In such circumstances it is not difficult to see that an additional obligation to repay a large incentive could be a penalty.

Ultimately, it would seem that the loss of an incentive or an obligation to repay an incentive consequent up on a breach will likely be a penalty where the sum involved is wholly disproportionate to the loss actually suffered by the landlord, and particularly where that loss is otherwise capable of being compensated through damages and interest.

7. Termination of options and Section 128 of the PLA

7.1 Restrictions based on breaches

Lease option clauses commonly contain a provision like the following:

19.2 Conditions for grant of further term

The Landlord must grant to the Tenant and the Tenant must take a lease of the whole of the Premises for the Further Term at an initial Base Rent determined under clause 19.3, if all the following are satisfied:

(a) ...;

(b) payments punctually made: the Rent and other money payable to the Landlord under this Lease have been duly and punctually paid;

(c) no breach: the Tenant is not in breach of this Lease at the date of service of the Tenant’s Notice or at any subsequent time during the Term (unless the breach has been waived in writing by the Landlord or has been remedied to the Landlord’s reasonable satisfaction within a reasonable time after service on the Tenant of notice specifying the breach);

The intent is to invalidate the exercise of an option where a tenant is or has been in breach of the lease. Section 128 of the Property Law Act 1974 imposes a substantial limitation on such clauses.

7.2 Section 128 Property Law Act 1974

Section 128 is relatively long and detailed, but the key part of the section is as follows:

“(4) Where an act or omission that constituted a breach by a lessee of the lessee’s obligations under a lease containing an option would, but for this section, have had the effect of precluding the lessee from exercising the option, the act or omission shall be deemed not to have had that effect where the lessee purports to exercise the option unless, during the period of 14 days next succeeding the purported exercise of the option, the lessor serves on the lessee prescribed notice of the act or omission and” the Tenant does not within 1 month apply for relief from forfeiture, or the relief is not granted, or there is a breach of a condition in the order for relief.
The first risk to these clauses is that the landlord fails to give the prescribed notice within the 14 days. That is not a long period and could easily lapse before the landlord gets around to seeking legal advice about whether the option can be refused. Accordingly steps need to be taken to ensure that the landlord is aware of section 128. One useful approach is to make it clear in the option clause that the section applies to the refusal of the option.

16 Option

16.1 Grant of Option

Subject to the conditions stated in this clause 16, the Landlord grants the Tenant an Option to extend the term of this lease for each Option Period.

16.2 Exercise of the Option

The Tenant may only exercise an Option by giving notice to the Landlord not more than nine months and not less than six months before the Expiry Date.

A notice of exercise of an Option that does not comply with this clause 16.2 is ineffective to exercise the Option unless the Landlord gives the Tenant a notice in which the Landlord expressly elects to accept the exercise of the Option.

16.3 When Option not validly exercised

The Tenant's exercise of the Option is ineffective if:

(a) at the time of exercise the Tenant is in breach of this lease; and

(b) the Landlord gives the notice required by section 128 of the Property Law Act 1974.

Section 128 was considered in Capital Projects (Qld) Pty Ltd v Trust Co of Aust Ltd. The Landlord refused to accept the exercise of the option by a tenant who was a serial delinquent with rent payments, regularly ranging from 2 weeks to 2 months late. The Landlord gave the proper notice under section 128 and then offered the tenant a new lease on altered terms. The tenant sought relief under section 128.

Martin J granted the relief, deciding that:

■ section 128 provides a wide discretion for the Court;

■ the landlord must prove the breaches and the tenant must establish the grounds for relief;

■ late payment of rent does not justify forfeiture of the option if the landlord is not prejudiced by that failure;

■ it is more important to look at the quality of the relationship between the parties, has it essentially failed because of the degree to which the parties are in dispute;

■ the offer from the landlord to grant a new lease on different terms was evidence that the relationship had not failed

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8. Drafting default and termination provisions

It is clear from the cases that default and termination provisions need to be carefully and clearly drafted.

21 Breaches and termination rights

21.1 Essential terms

Clauses 2, 5, 8, 9, 11.1, 11.2, 11.4, 11.5, 11.6, 11.7, 11.8, 12, 18, 19, 20 and 21.2 are essential terms of this lease. Other clauses may also be essential terms.

21.2 Interest on late payments

If the Tenant does not make a payment on time, it must pay, on demand by the Landlord, interest at the Interest Rate on that amount from the due date for payment until it is paid. Interest is:

(a) capitalised monthly if not paid; and
(b) calculated on daily balances of the amount outstanding for the original payment and capitalised interest.

21.3 Right to remedy Tenant’s breaches

If the Tenant does not remedy a breach of this lease within a reasonable time after receiving notice to do so, the Landlord may take reasonable steps to remedy that breach.

The Tenant must pay the reasonable costs incurred by the Landlord exercising its right under clause 21.3 to remedy a breach of this lease by the Tenant. The payment must be made within seven days of written demand giving reasonable details and evidence of the costs.

21.4 Landlord’s termination rights

The Landlord may terminate this lease if:

(a) the Tenant breaches any provision of this lease and does not remedy the breach within a reasonable time after being given a notice specifying the breach and requiring the Tenant to remedy it; or

(b) entitled to do so under another clause in this lease; or

(c) the Tenant is insolvent (see clause 21.6).

21.5 Notice of termination

If under a law, the Landlord must give notice in a particular form before exercising a right to terminate this lease then a notice in that form is a notice for the purposes of clause 21.4(a).

21.6 Insolvent

For the purpose of clause 21.4(c), “insolvent” includes, for a person, when:

(a) the person is insolvent as defined in the Corporations Act 2001;

(b) the person is an “externally-administered body corporate”, as defined in the Corporations Act 2001.
(c) a controller, as defined in the Corporations Act 2001, has been appointed with respect to property of the person;

(d) the person has committed an act of bankruptcy, or is bankrupt, both as defined in the Bankruptcy Act 1966;

(e) the person has entered into, or is subject to, any arrangement, assignment or composition for the benefit of creditors; and

(f) the person, or the person’s assets, are in any way protected from the person’s creditors under any statute.

21.7 Method of termination

If the Landlord is entitled to terminate this lease it may do so by notice or by re-entry into possession.

21.8 Other rights not prejudiced

The exercise by the Landlord of rights under this clause 21 does not prejudice any of the Landlord’s other rights under this lease, at law or otherwise.

22 Indemnity and release

22.1 Indemnity

The Tenant indemnifies the Landlord against all liabilities, losses, costs, expenses or damages incurred or suffered directly or indirectly in connection with any of the following:

(a) the negligence or default of the Tenant or the Tenant’s Employees and Agents; and

(b) any third party, including an Employee or Agent of the Tenant, making a claim or taking action against the Landlord because of any death, personal injury, or any damage to property, or loss of property, occurring in the Premises; and

(c) a breach of this lease by the Tenant; and

(d) the Landlord rectifying a breach by the Tenant; and

(e) if the Landlord exercises a right to terminate this lease under clause 21.4 or because the Tenant repudiates this lease:

(i) costs and expenses the Landlord incurs seeking and granting a lease to replacement tenants and leases, including the costs of incentives granted to tenants; and

(ii) the loss of future Rent and other payments under this lease, but less the amounts of rent and other payments received from a replacement tenant for the Premises or part of them.
PLA Form 7
Version 1

NOTICE TO REMEDY BREACH OF COVENANT

Property Law Act 1974, section 124

To

The lessee of [here describe premises with reasonable certainty as for instance, “No 800 George Street, Brisbane”] (“the premises”).

With reference to the lease of the premises, dated the day of 20 , for a term of commencing on the of and the covenant by the lessee [here state concisely the nature of the covenant or covenants breach of which is complained of, as for instance “to repair”], and the breach by you of that covenant I give you notice and require you to remedy that breach by [here set out the remedy as, for instance, “by putting the premises in repair by doing and executing the repairs specified in the annexed Schedule to the premises within x days.”] ([Add if compensation is claimed] And I further require you to pay to me the sum of $ as compensation for the breach already committed.

Dated this day of , 20 .

[Lessor]

[NOTE: The lessor will be entitled to re-enter or forfeit the lease in the event of the lessee failing to comply with this notice within a reasonable time – see section 124 of the Property Law Act 1974.]

[ADDITIONAL NOTE: If arrears of rent or other periodic payments are being claimed, it should be made clear the amounts involved and the periods to which they relate; eg base rent: March 1995 - $x..]