

Property NewsFlash

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Terminating a lease

Landlords are often faced with the situation where a tenant has breached a lease provision. Common examples are:

- tenants failing to pay their rent and share of outgoings on time;
- tenants failing to maintain the premises;
- tenants altering the premises without the landlord's approval;
- tenants failing to take out all insurance cover as required under the lease;
- tenants using the premises for a purpose outside the permitted use; and
- tenants subletting the premises without consent.

What options are available for landlords in such circumstances?

- Exercise a right of re-entry or forfeiture;
- Terminate the lease for repudiation or breach of an essential term;
- If the breach is capable of remedy, the lease may permit the landlord to remedy the breach and recover the cost from the tenant by accessing the bank guarantee or security deposit; or
- If the breach relates to non-payment of monies due, charge the tenant default interest until the money is paid.

The focus of this article is on termination of the lease either by exercising a forfeiture right under the lease or the common law doctrine of repudiation.

Repudiation

It is now well settled law that ordinary contractual principles apply to all leases. Accordingly, the doctrine of repudiation is now an alternative basis for determining leases.

Generally speaking there are 3 main types of repudiatory conduct:

1. where a tenant intentionally no longer wishes to be bound by the lease;
2. where a tenant intends to perform the lease only in a manner substantially inconsistent with his obligations and not in any other way; or
3. where a tenant has breached a fundamental or essential term of the lease.

The first two limbs abovementioned are characterised as general repudiatory conduct. The third limb is more specific in nature, as it relates to the breach of a specified essential term of the lease.

1. General repudiatory conduct

Some caselaw examples of general repudiatory conduct are:

- a. a landlord's failure to register a lease when required to do so under the lease;
- b. a tenant's failure to pay rent and to comply with their repair obligations under the lease;
- c. a tenant withholding rent and outgoing payments;
- d. gross breaches of a quiet enjoyment provision by a landlord; and
- e. a tenant abandoning the premises and returning the keys to the landlord.

However, the tenant's failure to pay rent alone is not likely to constitute general repudiatory conduct.

General repudiatory conduct is not to be inferred lightly, and requires an objective assessment of all the circumstances relevant to the particular conduct to

determine the tenant's intention as to whether it intended to wholly renounce the lease or perform it in a manner substantially inconsistent with its terms.

2. Breach of an essential term

To circumvent the difficulties surrounding the application of the general repudiation doctrine, the courts have acknowledged landlords can specify in the lease which terms are essential in order for the landlord to terminate the lease without having to prove the abovementioned elements for general repudiation. Accordingly, most leases these days specify which lease provisions are essential to the lease bargain.

It is important that the essential terms specified in a lease are considered to be of particular importance and not cast too broadly, as a court may decide to strike down the effect of the clause.

However, a lease provision can still be treated as an essential term (even though it may not have been specified as such). The test for determining this is whether the term is of such importance to the landlord that it would not have entered into the lease unless it had been assured of a strict or substantial performance of the promise, as the case may be, and this ought to have been apparent to the tenant.

Forfeiture

Forfeiture is defined as a specified right under a lease for a landlord to determine it following a default by the tenant, which, when exercised, has the effect of bringing the lease to an end immediately.

Forfeiture usually occurs after a tenant breaches a condition of a lease or a

covenant (where there is a proviso for re-entry of the premises).

Forfeiture of a lease can be effected by either the landlord re-entering, or bringing an action to recover possession of, the premises.

Forfeiture or repudiation

A landlord is not required to make an election as between these remedies when it wishes to terminate the lease due to the tenant's default. They co-exist and may be exercised independently of each other.

However, there is a big distinction between these remedies, which needs to be carefully considered before exercising them.

- The forfeiture remedy will generally only allow a landlord to recover rent owing up to the date of termination unless the lease reserves to the landlord the right to recover loss of rent for the balance of the lease term if that remedy is exercised.
- Comparatively speaking, terminating the lease for repudiation will enable the landlord to recover damages for loss of rent for the balance of the lease term.

If a landlord chooses to terminate a lease for a tenant's repudiation, it must make an unequivocal election by words or conduct to accept the tenant's repudiation and terminate the lease. This can be done by issuing a notice of termination to the tenant and re-entering the premises.

Notice Requirements

Before terminating a lease for repudiatory conduct (including a breach of an essential term) or by forfeiture, landlords must ensure they comply with the notice requirements under section 146 of the Property Law Act 1958 (Vic). The section specifically does not apply to breaches relating to non-payment of rent.

Section 146 requires a landlord to first give a tenant a notice allowing a reasonable time to remedy the particular default before terminating the lease. If the tenant has not remedied the default within the notice period, the landlord may then terminate the lease.

Section 146 also allows tenants to apply to a court with equitable jurisdiction for relief

against forfeiture of a lease. The courts have a broad discretion as to whether it will grant such relief, and will generally do so if the tenant rectifies the breach, is not likely to repeat it and will suffer greater detriment by not granting the relief.

Mitigation of loss

Landlords must take reasonable steps to mitigate their loss following termination of a lease due to a tenant's default. This is usually done by a landlord seeking to relet the premises.

However, a landlord is only obliged to relet the premises to another tenant at a reasonable rent based on comparable evidence and on reasonable terms. In a falling market, this does not mean that a landlord is required to accept any rent that a tenant is willing to pay.

Conclusion

Termination of leases is a very complex area of law, and should not be taken lightly. Practically speaking, landlords should:

1. ensure their leases nominate key lease terms as essential terms and include a general right to recover loss of rent for the remainder of the term for any termination of a lease;
2. carefully consider their termination rights before proceeding (i.e. has the tenant breached an essential term or does the tenant's conduct amount to a general repudiation of the lease or should the landlord exercise a right of forfeiture?);
3. ensure compliance with s.146 of the Property Law Act when exercising a termination right;
4. consider whether a tenant would be entitled to obtain relief against forfeiture before exercising a termination right; and
5. ensure they mitigate their loss following termination of a lease.



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