Recent developments in property law

There have been two recent decisions worthy of note that considered the effect (or non effect) of clauses incorporated in licence agreements and leases respectively.

These judgments are of particular importance to young lawyers responsible for drafting agreements covering commercial arrangements between parties pursuant to which the right to occupy premises for specific purposes is granted. Care must be taken to incorporate clauses that express with adequate clarity the totality of the intention of the negotiating parties.

AN AGREEMENT WITH A 'NO EXCLUSIVE POSSESSION' CLAUSE IS A LICENCE NOT A LEASE

The Victorian Court of Appeals' decision in *KJRR Pty Ltd v Commissioner of State Revenue* (VSCA) 2(No 6329 of 1997) (24 March 1999) examined the commercial arrangement by which a licensee occupied land or part of a building for a specific purpose. In the relevant documentation, these arrangements may be labelled as concessions, licenses, leases or occupation rights. But for the purpose of various legislation which affect them, it has been necessary for courts to determine the true nature of these holdings. Despite the labels given in the documentation, the Court of Appeal's decision may mean that where a licence agreement contains a 'no right to exclusive possession' clause, it does not attract lease stamp duty. Neither does the inclusion of such a clause in a licence agreement mean that that it was included to avoid stamp duty.

First Instance

Sportsco was the tenant of commercial premises ("Premises") from which it conducted its retail sportswear business. In 1996 Sporstco and KJRR entered into a licence agreement for the Premises ("Sportsco lease"). At the same time the parties entered into a franchise agreement under which KJRR was a franchisee of the Sportsco line of sportswear.

Sportsco could:

- enter without notice during business hours to determine whether KJRR was complying with its franchise agreement;
- enter and inspect business records and other documents and to take copies;
- enter without notice and conduct an audit of books and records;
- operate and manage the business if it was abandoned.

When the licence agreement was submitted to the Commissioner of State Revenue ("Commissioner") for stamping it was assessed on the basis that the instrument was a lease.

The Commissioner argued that the agreement as a whole was in substance a lease disregarding as necessary any provision expressly ousting exclusive possession.

The instrument labelled as "licence agreement" provided that :

- in consideration of the payment of the licence fee and compliance with the conditions of the licence Sportsco granted KJRR a licence to use the Premises for the use only as a Sportsco Franchise Retail Store (clause 2.1);
- the right to exclusive occupation to the Premises was not conferred to KJRR and Sportsco could at any time exercise all its rights as Tenant (under the Sportsco lease) including its rights to use, posses and enjoy the whole or any part of the Premises save only insofar as such rights prevented the operation of the licence granted (clause 2.2) ("No Exclusive Possession Clause");
- the contractual rights granted do not create a tenancy or proprietary or other estate or interest in or over the Premises and the rights of the licensee are that of a licensee only (clause 2.3);
- the use of the Premises is confined to a Sportsco retail store;
- the licensee:
  - occupies the Premises at its own risk;
  - is to ensure compliance with Sportsco's lease;
  - is not to assign or transfer the licence or grant any sub-licence without Sportsco's consent (clause 14);

- the licence may be terminated on the termination of the franchise agreement or Sportsco's lease.

Court of Appeal decision

The Court of Appeal held that while clause 2.3 added no more than the label of the instrument itself that it was a licence, clause 2.2 was crucial to the ascertainment of the nature of the agreement between the parties (Tadgell J at paragraph 5). Clause 2.2 defined the rights by reference to the extent to which the parties could use the Premises.

The Court of Appeal unanimously decided in the absence of evidence to the contrary that the No Exclusive Possession Clause should not be ignored, but given its natural and practical effect and not be illusory. Tadgell J (with whom Callaway and Chernov JJ agreed in the result) considered that the Supreme Court had erred by relying on the pretence doctrine in English authorities, namely the frustration of transactions whose object was to avoid or evade statutory obligations (Tadgell J at paragraph 13).

Tadgell J held (and Chernov concurred) that in the circumstances surrounding the making of the agreement or in the conduct of the franchise business 'no evidentiary basis existed for the view that it was a pretence for KJRR not to have exclusive possession of the retail premises. … [There could] be no … inference that, in the absence of supporting evidence, that clause 2.2 was inserted in the licence agreement for the purpose of avoiding stamp duty so that it [was] on that account to be ignore as a pretence. Much less [was] there foundation for a conclusion that there was a 'sham." (Tadgell J at paragraph 18).

Further, it was not possible to conclude in the absence of information about the workings of the businesses of the parties, that any of those provisions amounted to no more than '…. a pretence or artifice designed to deceive or mislead the courts or authority'. The matters which the Supreme Court had take into consideration as elements of a lease (eg the licensee is to occupy the Premises at its own risk and is not to assign licence without Sportsco's consent, the licensee's rights are not to interfere with Sportsco's lease) were equally consistent with the taxpayer's claim that agreement was a licence in light of clause 2.2 (Tadgell J at paragraph 17).

It is understood that the Commissioner has sought special leave to appeal to the High Court of Australia.

A CONCESSION GAINED UP FRONT BY A TENANT ENDS UP AS A RENT INCREASE TO THE LANDLORD

The next decision shows up the illusory nature of what may have seemed to the tenant to be a concession gained up front.

The Victorian Supreme Court's decision in *Commonwealth of Australia v Wawbe Pty Ltd & Pinebark Park Pty Ltd* [1998] VSC 82 (25 September 1998) has been touted as a warning to tenants about the long-term value of upfront lease concessions as they may be negated by higher rents after a rent review particularly if the lease does not expressly exclude those concessions from being considered at rent reviews.

"The Court of Appeal unanimously decided in the absence of evidence to the contrary that the No Exclusive Possession Clause should not be ignored, but given its natural and practical effect and not be illusory. "

The landlord agreed that a tenant could fit out an empty building shell as an analytical laboratory ('Premises') and agreed the tenant would not have to 'make good' the Premises at the end of the lease. The tenant carried out a fitout of the Premises as an analytical laboratory and the landlord credited the tenant with the sum of $678,350.00 in lieu of the landlord carrying out the works in Schedule 4 to the lease which would have finished the building as an office building, as intended.

At the time of market rent review under the terms of the lease, the landlord hired a valuer who determined that the concession given to the tenant of not having to make good the Premises at the end of the lease term had a commercial value which the tenant should compensate the landlord for, paying higher rent for the remainder of the lease to offset the landlord's cost of making good the Premises.

The lease provided for lease reviews to be conducted every two years and, where the parties were unable to agree upon the rent review, 'the rent shall be determined pursuant to clause 4(9) and clause 4(10) provided that until the rent has been determined the rent applicable as at the date of such review shall continue to be paid but shall be subject to adjustment in accordance with such determination.'

The landlord and tenant were unable to agree on the rent payable following the rent review and, in accordance with clause 4(9) of the lease, each party appointed its own valuer who too were unable to agree as to the rent payable. At a conference the parties agreed that an umpire would be appointed by the President of the Real

Estate Institute of Victoria ('Umpire') in accordance with clauses 4(9) and 4(10) of the lease to determine the rental due as at the 6th June 1996 pursuant to the lease. The Umpire was obliged to determine 'a proper rent for the Premises' and this required him to consider the Premises in their permitted state as at 6 June 1996 and the provisions of the lease, particularly clause 4(10)(e).

Clause 4(10)(e) set out the matters which the valuers and the Umpire were required to consider in determining a proper rent for the Premises on any dispute in respect of review of rent namely:

'(i) assume that the premises form part of an ordinary average commercial office building of a kind commonly found in the vicinity;

(ii) exclude ... any and all value that may attach to the premises by reason of their use as a laboratory;

(iii) .. exclude .. any and all value that may attach to the premises by reason of those fit-out works added to the premises at the lessee's expense and set out in Schedule two;

(iv) .. exclude .... any and all value that may attach to the premises by reason of those building upgrading works added to the premises at the lessee's expense and set out in Schedule three;

(v) have regard to rents ruling in the vicinity in respect of ordinary average commercial office buildings and to such other matters, consistent with this Agreement, as may be relevant at the date on which such rent shall commence; and

(vi) in respect of the car parking spaces, have regard to rents ruling in the vicinity for similar car parking spaces;

(vii) take into account that the Lessor credited the Commonwealth with the sum of $678,350 in lieu of those works specified in Schedule 4 which would have finished the building as an office building.'

"The Court held that the rent to be ascertained by the review was that payable by a willing lessor and a willing lessee on the same terms and conditions as the lease."

The Umpire made a determination taking into account that there was no requirement to reinstate the Premises at the end of the lease and that the lessee was relieved of this obligation ('Reinstatement Factor').

The Court held that the rent to be ascertained by the review was that payable by a willing lessor and a willing lessee on the same terms and conditions as the lease. The Umpire rightly took into account the Reinstatement Factor 'unless it was not consistent with this (the) agreement' (Gillard J at paragraph 81). '..[I]in the circumstances a lessee would derive a benefit from this fact for which he should pay in the form of an increased rent to the lessor to cover the prejudice suffered by the landlord in having to reinstate the premises from a laboratory to an office at the expiration of a lease. In other words, the lessor if desired would have to re-instate the premises and since the willing lessee did not have to find the cost of reinstatement it meant that a willing lessee, in those circumstances, would be prepared to pay a higher rental. ...[and] neither individually nor collectively do the factors set out in clause 4(10(e) exclude the consideration of the reinstatement factor in the valuation process.' (Gillard J at paragraph 70 and 82) (emphasis added).

The Court further held that the Umpire was also obliged to consider 'such other matters consistent with this agreement, as may be relevant at the date on which such rent shall commence.' The Reinstatement Factor was relevant to the valuation process and was not excluded by clause 4(10(e) or any other clause of the lease (Gillard J at paragraph 90).

Comment

If negotiating parties intend that a particular upfront concession is a special benefit granted to a tenant and is not to be recouped by the landlord in any form, including by way of a rent increase at each rent review date, an express provision may have to be included in the lease to that effect.

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