More than words

Powers of courts and tribunals to rectify a lease

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In light of the Administrative Decisions Tribunal's decision in the Toga case, lawyers need to be aware of the grounds upon which courts and tribunals can vary signed leases.

The Administrative Decisions Tribunal (the tribunal) has implied a term into a lease that the parties must give "fidelity to the bargain" in order to overcome the effect of a written term in a lease, in its ground-breaking decision of *Toga Pty Limited v Perpetual Nominees Limited and CFS Managed Property Limited* [2012] NSWADT 80 (*Toga*). This appears to be the first time the tribunal has used the principle of fidelity of the bargain to circumvent unambiguous provisions in a signed and registered lease, which due to an error in drafting inadvertently provided a further one-year rent-free period in the option term

By this method, and using its power to declare the rights and liabilities of the parties, the tribunal overcame the limitation in the *Retail Leases Act 1994* that only gives it power to order rectification of a lease with the consent of both parties.

Just a month after *Toga* was handed down, the Supreme Court considered the principles of rectification of a lease in *Casquash Pty Limited v NSW Squash Limited (No 2)* [2012] NSWSC 522 (*Casquash*). In *Casquash*, the Supreme Court ordered that the lease be rectified by reinstating an outgoings clause which was dishonestly deleted from the lease by the tenant, without the consent of the landlord. Consent of both parties is not required to rectify a lease in actions heard by the Supreme Court.

It is understood that Toga has filed an appeal and it remains to be seen how the fidelity of the bargain principle will be applied in future cases before the tribunal. However, both decisions are examples of the power of the court and tribunal to vary the written and signed lease agreement. Lawyers must be mindful of these principles when advising clients in relation to possible actions in similar circumstances.

Toga

Perpetual Nominees Limited and CFS Managed Property Limited (the landlord) granted a sublease to Toga Pty Limited (the tenant) of retail premises near Central Station in Sydney for a term of 10 years with a 10-year option to renew.

Item 14 of the reference table of the sublease provided that: "The Lessee is not obliged to pay the Annual Rent or the Lessee's Contributions for the period up to the first anniversary of the Commencing Date." Thus, the tenant was entitled to a gross rent-free period that is, both a base rent and outgoings free period, for the first year of the sublease.

The problem in *Toga* arose upon exercise of the option. Clause 16 of the sublease dealt with the option to renew (the option clause). The option clause stated that the annual rent would be increased by an agreed percentage and the renewed lease would exclude clause 16, and items 15 and 16 of the reference table and would contain rent variations as specified in item

16 of the reference table. There was no mention of excluding item 14, the "rent free clause", during the option term.

The tenant asserted that it should be entitled to a one-year rent-free period on exercise of the option.

The landlord asserted the contrary position; namely, that item 14 should be omitted from the sublease, even though the sublease, under the option clause, does not state that it is to be deleted.

Surprisingly, the option clause also did not actually state that the option lease would be in identical terms to the existing sublease. However, the tribunal applied *Lewis v Stephenson* (1898) 67 LJQB 296,[1] which held that "a renewal of a lease means the renewing of the lease ... on the same terms".

Thus, the tribunal determined that the option lease was to be read as being on the same terms as the initial sublease except for the exclusion of clause 16, and items 15 and 16 of the reference table and that the rent was to be determined in accordance with item 16.

Flowing on from this interpretation, the rent-free period was incorporated into the sublease for the option term as the sublease failed to exclude item 14. Usually one would specifically delete item 14 just as items 15 and 16 were deleted, if one did not intend the option sublease to also contain the rent-free period.

The provisions of the lease and the evidence of the parties

Both parties gave evidence to the effect that a letter (the Harris letter) dated 10 December 1988 from Mr Robert Harris, the leasing agent, to Mr Ganci of the landlord, records the agreed terms of the lease. The tenant, however, asserted there was an additional agreement in relation to the rent-free period that was not contained in the Harris letter.

The Harris letter stated "the agreement is subject to Toga receiving one year's gross rent free to be adjusted in the last month". The Harris letter also states "Toga's offer is subject to formal documentation".

Mr Allan Vidor, on behalf of the tenant, gave evidence that Toga conveyed its position to Mr Harris that it required another rent-free period in the option term. Mr Vidor said that he understood that the lease was to include a rent-free period at the commencement of both the initial term and the option term.

Mr Harris, the leasing agent, gave evidence on behalf of the tenant, which of itself is unusual. He confirmed that Mr Vidor requested him to seek a rent-free period to apply during the option term. Mr Harris said that he advised the landlord of this requirement and that the landlord's representative had said that he agreed to Toga's terms.

Mr Ganci gave evidence on behalf of the landlord that it would be inconsistent with his commercial practice and would be both unusual and imprudent to grant a one-year rent-free period also for the option term. He referred to the fact that there was no such entry in his notebook.

Mr Gray, a witness for the landlord, denied that the landlord had reached any agreement that there would be a further rent-free period during the option term.

"While the tribunal did not have the power to rectify the lease without consent of both parties, the tribunal determined that by not agreeing to rectification, the tenant was denying the landlord the benefit of the bargain."

Mr Cohen, the solicitor who prepared the sublease, attested that a rent-free period in an option lease was very unusual and rarely given and that, inter alia, he never received instructions to include such a provision in the sublease.

Thus, the question to be answered is whether the lease provides for a rent free period in the first year of the option term.

If one looks at the Harris letter, it only refers to there being a one-year gross rent-free period. However, the tenant and Mr Harris both argued that the tenant requested that there be a one-year rent-free period in the option term. Mr Harris thought this was granted by the landlord. The landlord, however, strongly denied through its witnesses that it ever agreed to there being any rent-free period in the option term and further, its lawyer testified that this was consistent with his understanding of the transaction.

High Court authority – Codelfa

The tribunal considered the High Court decision of *Codelfa Constructions Pty Limited v State Rail Authority of NSW* (1982) 149 CLR 337 (*Codelfa*) as authority that "it is essential that ambiguity in the language of the contract be identified before a Court may have regard to the surrounding circumstances and object of the transaction".[2]

The tribunal stated that notwithstanding some divergence in views since Codelfa, the High Court in *Western Export Services Inc v Jireh International Pty Limited* [2011] HCA 45 stated that *Codelfa* remains binding authority.[3]

The tribunal chose to apply the rule in *Codelfa* and stated that "evidence of the surrounding circumstances of the Sublease cannot be called upon to construe the plain language in Item 14. The Tribunal finds that Item 14 was not specifically excluded from the Option Lease and thus Item 14 is included. There is no ambiguity on that point and there is no ambiguity on the meaning of 'commencement date' in Item 14".[4] As there was no ambiguity, the tribunal was required to give the words in the contract their plain meaning and apply these.

The law in relation to rectification

The tribunal stated that the principles regarding the application of the remedy of rectification were summarised by Sackar J in *Powell General Sheet Metal Pty Limited v Autopak Nominees Pty Limited* [2011] NSWSC 321.[5] His Honour said: "To obtain an order for rectification for common mistake, the Plaintiff must show the existence of a common intention which continued in the mind of both parties up until the time of the contract." Sackar J then cited Isaacs J's decision in *Bacchus Marsh Concentrated Milk Co Limited v Joseph Nathan and Co Limited* (1918) 26 CLR 410 (*Bacchus Marsh*), saying that "the purpose of rectification is not to import additional or different terms in the contracts but rather 'to reform instruments so as to make them accord with what the parties actually agreed to, or with what one party intended and the other party knew the first intended' ... there must be 'convincing proof ' of 'a continuing common intention' that runs contrary to the actual terms of the agreement. As such, the omitted agreement must be capable of such proof in clear and precise terms".

Common intention – What is the bargain?

Following on from the principle referred to by Isaacs J in *Bacchus Marsh* and Mason J in *Codelfa* that "the purpose of rectification is to reform instruments to make them accord with what the parties actually agreed", the tribunal found the following matters relevant in establishing what the parties in *Toga* actually agreed.

First, was the fact that the Harris letter made no mention of any rent-free period to be repeated in the second term. There was also the fact that Mr Ganci kept a notebook and there was no record of the second rent-free period in the notebook.

Second, Mr Harris admitted that the Harris letter was poorly drafted

Third, there was to be an adjustment of rent in the last month of the rent-free period for payment of services and such adjustment would be irrelevant if there

was a second annual rent-free period

Fourth, the landlord's solicitor confirmed that he never received instructions to draft a provision to cater for a second rent-free period. While Mr Vidor said in evidence that he had requested a second rent-free period, there was no evidence from the landlord to say this had been agreed to.

Finally, the tenant had received a copy of the Harris letter and did not query the omission of the rent-free period.

Taking into account the above factors, the tribunal determined that the bargain between the landlord and tenant was that there was to be only one rent-free and outgoings-free period and it was not to be repeated in the option lease.[6]

Does the tribunal have the power to rectify the lease?

Section 70(a)(vii) *Retail Leases Act* states that a retail tenancy claim includes a claim regarding the rectification of the lease. Section 72(1)(e) states the tribunal can make an order, by the consent of the parties, requiring the parties to the proceedings to rectify a lease.

The tribunal referred to *Prasad v. Fairfield City Council* [2000] NSW ADT 164 as authority that it could hear a matter concerning rectification and quoted from the judgment that "the restriction in Section 72 ... is not reflected in Section 70, which is a jurisdictional section. Section 72 is ancillary to Section 70 and simply refers to the casting of the orders after the claim is heard".[7] The tribunal also referred to *Trustees of the Pious Society of St Charles v Vodap Pty Limited* [2004] NSW ADT 71 and *Chronopoulos v Carossel Pty Ltd* [2010] NSWADT 191 as supporting this position.

The tribunal then stated that "it is this Tribunal's view that it has the jurisdiction to make certain orders consequent upon the finding by the Tribunal with respect to the bargain between the parties that was struck".[8]

Fidelity of the bargain

The tribunal then referred to the case of *United Group Rail Services Ltd v Rail Corporation New South Wales* [2009] NSWCA 177 which discussed the concept of fidelity of the bargain: "The notion of fidelity to the bargain can be seen as founded, at least in part, on the requirement of a party to do all things necessary to enable the other party to have the benefit of the contract."[9]

While the tribunal did not have the power to rectify the lease without consent of both parties, the tribunal determined that by not agreeing to rectification, the tenant was denying the landlord the benefit of the bargain.[10] "Consequently Toga is not acting in accordance with the implied duty of good faith in performing its obligations and exercising its rights with respect to the Sublease and not doing all things that are necessary on its part to enable Colonial to have the benefit of the bargain."[11]

Thus, the tribunal held that the option lease did include the further one-year rent-free period, but there was an implied term in the lease that each party must uphold the fidelity of the bargain for the benefit of the other party and the tenant was in breach of this implied term by not consenting to rectify the lease.[12] Therefore, the tribunal, under s.72(1)(f)(iii), had the power to declare the rights and liabilities of the parties and accordingly declared that the tenant must pay rent for the first year of the option term.

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Overview of Toga

It is apparent that Judicial Member Bluth has provided a detailed and well-considered judgment, with a view to achieving a just outcome in the circumstances of the case, as it would appear unjust for the landlord to be denied one year's rent during the option term.

There may be some concern that the concept of fidelity of the bargain should apply where the implied term contradicts the express and unambiguous term in the lease. There was no ambiguity of the wording in the lease,[13] and no evidence that the tenant misled the landlord (which was the case in *Casquash*). Yet, the tribunal intervened and gave effect to an implied term.

Also, it could mean that too much weight can now be placed on a letter from an agent, which contradicts a signed and registered lease, the terms of which were drafted and negotiated by the parties' lawyers, and it being the document which the parties intend to create the binding legal relationship. This can create uncertainty in leasing transactions – particularly bearing in mind that a lease can be assigned and the property sold, such that the ultimate landlord and tenant at the time that the option is exercised may have no knowledge of the bargain. It is worth noting that the tribunal in *Toga* intervened more than 10 years after the lease was entered into.

Recent Supreme Court authority

A month after the tribunal's decision in *Toga*, the NSW Supreme Court handed down its decision in *Casquash*.

In *Casquash*, the parties had agreed that the tenant was to pay outgoings but the tenant and her solicitor brother dishonestly amended the lease to remove this obligation, without the agreement of the landlord, such that the improperly amended lease was registered.

Pembroke J delivered a well-written judgment in which his Honour ordered rectification of a lease. His Honour referred to the fact that "we adhere to the objective theory of contract, it does not matter what a party believes he or she agreed to. The hopes, aspirations, mistakes and misconceptions that a party might have about the meaning or effect of the contract are irrelevant".[14]

His Honour said the negotiations and communications of the parties' intention "merge in the language of the contract chosen by the parties and are subsumed by it" and it will only be in limited circumstances that the court will intervene. His Honour said "the parties are stuck with the language of the contract which they have signed, whether that language accords with their individual understandings or not ... absent fraud or some other special circumstance, a person cannot escape the consequences of signing a contract simply because he or she did not understand it or did not read it or did not take the trouble to discover its contents".[15]

Pembroke J went on to state that there was an exception where the mistake was the result of dishonest conduct, in which case equity can intervene. In this case, his Honour determined that the tenant and the tenant's solicitor acted with "guile and deception in taking advantage of the defendant's mistake" and accordingly ordered rectification. Relevantly, his Honour stated that there was a heavy responsibility on the parties' solicitors to ensure that the written contract reflected their clients' intentions.[16] □

ENDNOTES

1. Referred to with approval by Aspery JA in *195 Crown Street v Hoare* [1969] 1 NSWR 193.
2. *Toga* at [59].
3. *Toga* at [60].
4. Ibid at [67].
5. Ibid at [71].
6. Ibid at [80].
7. Ibid at [96], quoting from Prasad at [303].
8. Ibid at [101].
9. Ibid at [102], citing *United Group Rail Services Ltd v Rail Corporation New South Wales* [2009] NSWCA 177, at [638].
10. Ibid at [110].
11. Ibid.
12. Ibid at [114].
13. *Toga* at [60], citing the requirement set out in *Codelfa*.
14. *Casquash* at [3] and [4].
15. Ibid at [4].
16. Ibid at [5] and [8]. □