IS EMAIL AN OPTION?
NOTICE TO EXERCISE AN OPTION TO RENEW IN A LEASE

By Anthony Herro

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A business, particularly a retail business, is dependent on its lease. A profitable business with only two years of the lease term remaining cannot command the same purchase price as the same business with five years remaining. For a tenant who has negotiated an option to renew, it is critical that – if the tenant wishes to exercise its option – it does so correctly, strictly in accordance with the lease.

Occasionally tenants have a misinformed view and think verbal communication is sufficient, but this does not amount to valid exercise of an option. Solicitors must be mindful, when acting on a purchase of a business subject to a lease which contains an option, to comprehensively advise their clients of the existence of the option and how to correctly exercise it.

It can be financial disaster for a client to pay $500,000 for a business with a lease for two years, with a five-year option, and to fail to exercise the option in time or in accordance with the lease. The outcome could be that the landlord can negotiate unreasonable terms for a new lease or refuse to grant any additional term at all, such that the value of the business is greatly diminished. It is very important to avoid these pitfalls by providing clients with a detailed letter of advice after settlement in relation to the option to renew, and then follow this up with a further discussion on the importance of properly exercising the option. It is always recommend that one take a conservative view by strictly complying with all the requirements of the lease.

Exercise of option by email

Email is becoming the most common means of written business communication. So can an option be exercised by email?

The Supreme Court of New South Wales considered this question in *Kavia Holdings Pty. Limited v Suntrack Holdings Pty. Ltd* [2011] NSWSC 716 *(Kavia)*. Kavia Holdings Pty. Limited (the Tenant) held a 10-year lease (the lease) with Suntrack Holdings Pty. Limited (the Landlord) in the Harbourside Shopping Centre in Darling Harbour, trading as "Jordans". The Lease contained a 20-year option to renew.

Snapshot

- The decision in *Kavia Holdings Pty. Limited v Suntrack Holdings Pty. Ltd* [2011] NSWSC 716 states that email may constitute valid service of the exercise of the option to renew a lease in writing
- The notice will not be deemed 'absolute and unqualified' if the tenant tries to hedge its bets, impose qualifications or point to the need for further negotiations
- Email is still not recommended as a form of service. Tenants are best served by following a conservative course by acting strictly in accordance with the lease

The Lease expired on 20 June 2011 and if the Tenant wished to accept the option, it had to do so, inter alia, by written notice served between 1 July 2010 and 31 December 2010.

Mr Crawley of the Tenant sent to Mr Andrews of the Landlord an email (the email) on 18 August 2010 which contained six numbered paragraphs, with the sixth paragraph being as follows:

'I am just considering and it is probably worth the lessors while as well, that we tie all the leases up for the full term that we can expect. I would like to have at least another 20 years with Jordans lease and tie that in with Cohibar and Watershed so that they are a composite assist in the books of Kavia. There are benefits both ways by doing such an agreement '(at [7]).

This case is important for two reasons. It considers whether the communication was sufficient to exercise the option and whether email is an acceptable method by which an option can be exercised. Justice Pembroke made reference to the following points regarding the context of the email. First, it covered a number of separate matters. Second, the relevant sentence appeared in the sixth numbered paragraph headed 'New lease documents'. Third, the sixth numbered paragraph concerned multiple leases. Fourth, the writer did not make express reference to any option to which the tenant may be entitled (at [8]).

The email was sent in response to an email from Mr Andrews of the Landlord dated 6 August 2010 where he enquired: 'Could I please have the leases executed or at least feedback? So we may move forward … I appreciate you are busy but the stalling and manipulation to suit your agenda is now impacting on myself personally and creating unrequired anxiety not in the spirit of the relationship' (at [6]).

The email contemplated further negotiations and contained qualifications. The first qualification was that Mr Crawley wanted a lease for 'at least another 20 years'. The second was that he wanted to tie the lease with the two other leases.

The court emphasised that the subjective belief of Mr Andrews in relation to the email is irrelevant. The question to be determined is an objective test, being 'what a reasonable person in the lessor's position would have clearly understood' (at [12]).

Justice Pembroke stated:

'Because the characterisation of the lessee's written communication is an objective question, it does not matter what particular misconceptions, errors or oversights may have affected the understanding or intention of either the lessor or the lessee. All that matters is that the written communication satisfy the contractual requirements' (at [14]).

The contractual requirements are set out in the relevant option clause in the lease. The Tenant 'need only give notice in language that would be reasonably clear to a reasonable person in the lessor's position that he desires to take a further lease of the premises for the further term of years set out in the reference schedule' (at [15]).

The Tenant cannot 'hedge its bets, impose its own qualifications, or point to the need for further negotiations. This is

the sense in which it is sometimes said that the notice must be "absolute and unqualified"' (at [22]). It must be that the notice itself (not the subsequent conduct of the parties) shows with reasonable clarity – and with the absence of qualification – that a reasonable person in the Landlord's position would have understood the Tenant was giving notice to exercise the option.

The court makes reference to the fact that the unilateral conduct of a tenant (by exercising the option) significantly impacts a landlord, namely, that it binds the landlord to a lease for the further term – in this case, a period of 20 years. In this case, the court characterised the email as simply a step in the negotiation process, rather than a notice of exercise of option, as it was subject to two qualifications and contemplated further negotiation between the parties.

Can an option be exercised by email?

The court then turned its attention to whether service by email would have deemed the notice invalid. The lease provided that all notices *must* be in writing and may be served by being left at the address specified in the reference schedule. The lease also said that any notice may be signed on behalf of a party by a director, manager, secretary or acting secretary. The court held that the email did satisfy the requirement that the notice be in writing.

The lease provides that it may be served by being left at the address in the reference schedule. Because the word 'may' is used, physical delivery is not a mandatory requirement but simply one method of acceptable service. Also, service by email was considered to have complied with the requirement for the notice to be signed. In relation to the requirement for signing, the court determined that the inclusion of the sender's name amounted to 'signing' as the name of the sender and his email address is 'readily and rapidly verifiable'. The court went on to say: 'Any other conclusion would produce a capricious and commercially inconvenient result that might have wide-reaching and unintended consequences in modern day trade and commerce' (at [33]). Justice Pembroke said that even if he was wrong in relation to the requirement for signing, the fact that the lease states it may be signed by certain persons did not mean all notices must be signed. The court held the option was not exercised, predominantly because the email would be considered by a reasonable landlord to simply be a step in the negotiation process, rather than being an 'absolute and unqualified' notice of exercise of option.

Conclusion

This case highlights the following points relevant in practice:

1. Email satisfied the requirement that the notice be in writing.

2. The test to be applied is whether a reasonable person in the Landlord's position would have clearly understood that the Tenant was giving notice of a desire to exercise its option.

3. The notice will not be deemed 'absolute and unqualified' if the Tenant tries to hedge its bets or impose its own qualification or point to the need for further negotiations

4. Notwithstanding this decision, I would recommend that email not be used as a method of service, but that one take a conservative approach to service of a notice to exercise an option and comply strictly with the method of service set out in the lease. **LSJ**