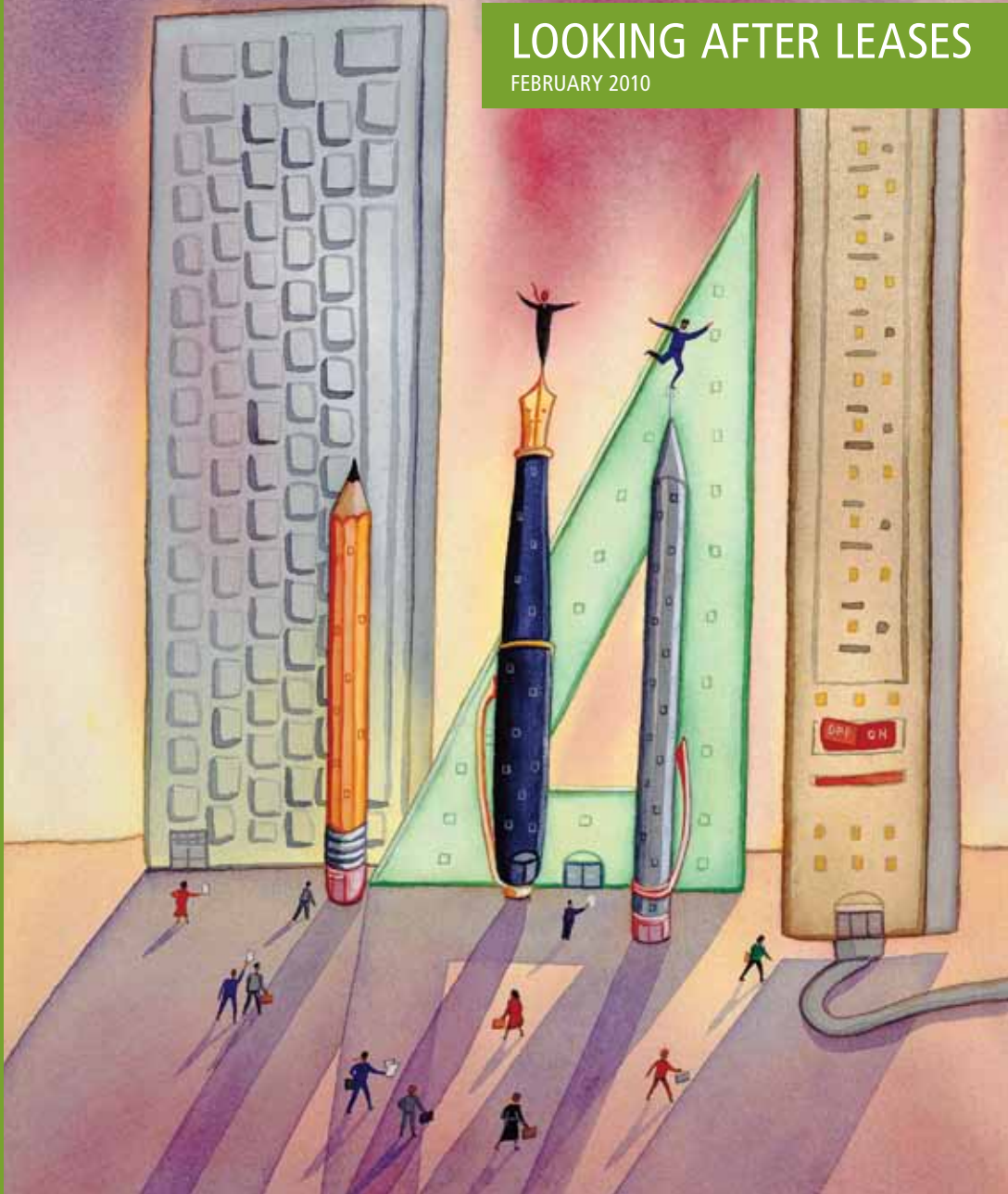


LOOKING AFTER LEASES

FEBRUARY 2010



LEGAL
PRACTITIONERS'
LIABILITY
COMMITTEE

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Introduction

Looking After Leases (February 2010 edition) has been produced by LPLC to help solicitors avoid common mistakes made in lease transactions.

This booklet is designed to raise your awareness of common problems in lease transactions and help you to protect your practice against claims. Commercial lease claims account for slightly more than half of the lease claims seen at LPLC, with the balance of claims generated by leases governed by the *Retail Leases Act 2003 (Vic)*. Residential leases are beyond the scope of this booklet.

LPLC is here to help, so if you need advice about looking after leases, please contact us on (03) 9672 3800

The best risk management

The two most common underlying causes for lease claims are simple oversight and problems arising from failure to manage the engagement.

The best risk management for leases is to use the checklist at the back of this booklet and, in particular, ensure that there is an exchange of letters between the solicitors for the parties setting out the basic terms and conditions agreed and the scope of the retainer.

Ensure that your client sees and confirms the content of the letters before they are sent.

If there has been a misunderstanding between the parties, it can often be detected and resolved at this early stage.

If a drafting error occurs, then there is a prospect of having it rectified to accord with what was agreed in the correspondence.

A written record, even a basic one, of what the parties have agreed has proved valuable to LPLC on many occasions, enabling leases to be rectified.

Checking that the version of the lease to be executed reflects the agreement between the parties and the client's instructions is a simple step that also enables errors to be detected at an early stage.

Careful retainer management is crucial where the client's proposed course of conduct is commercially risky. If the client is determined to proceed, ensure they are fully informed and prepared to carry the risk.

The problem areas

1. Drafting errors and omissions

Claims continue to be caused by a failure to check that the lease about to be executed reflects the parties' agreement, the client's instructions and the drafters' intentions.

Renewals and sub-leases are particularly vulnerable where the original lease is used as a precedent.

EXAMPLES:

Letter of offer differs from signed terms

Sometimes the problem is as simple as a discrepancy between the terms outlined in a letter of offer and the terms of the signed lease: for example, first right of refusal omitted from the lease or car parks not included in the lease. If the change was made by negotiation between the parties, this needs to be clearly documented on file.

Wrong party named

As a leasehold interest is a legal estate, the grant needs to be made by the party entitled to the legal estate, namely the registered proprietor.

We have seen claims where the tenant's solicitor has used the wrong name for the lessor in the lease. The solicitor failed to do a title search of the property to confirm the correct name of the lessor. The problem for the tenant arose when the property was sold and the new owner wanted to redevelop the property and could therefore argue that the lease was not valid.

Wrong plan

A drafting error by the solicitor for the tenant resulted in the entire property being sub-let instead of just the part agreed. In another case, the plan attached to the sub-lease was not identical to the one attached to the head lease, leading the sub-tenant to claim that the sub-lease was defective.

In other claims, a superseded plan was attached to the lease, the solicitor having failed to obtain an up-to-date plan and ensure the correct area of the premises, corresponding with the parties' intentions, was leased.

Mere licence

In a number of cases the landlord purported to include in the lease an area that was held by the landlord under a mere licence (typically, outdoor dining or drinking areas). Misunderstood rights to the leased area can trigger costly disputes where the disputed area is integral to the value of the business. In some cases the problem is detected only upon the tenant's attempt to assign the lease. The legal basis of the landlord's entitlement must be ascertained and correctly described in the lease.

Consequential changes

Cross references within a lease to a non-existent clause or to the wrong clause can have catastrophic results for the interpretation of the lease. In one claim, an additional clause added very late in the negotiations changed the numbering of clauses. This affected a cross reference within another clause, resulting in a changed rent review clause with dire results for the landlord.

Maths not right

It is common for rental disputes to arise from incorrect calculations or figures in lease documents. This can be as simple as the wrong dollar amount inserted or more complex mistakes such as untested mathematical formulae. LPLC has seen cases where a complicated formula for calculating rent was effective for the first years of the lease but had unintended results when applied post-renewal. Test calculations will usually prevent this kind of error being introduced into the lease.

The language of obligation

In one claim, there was an understanding between landlord and commercial tenant that the landlord would undertake an upgrade of lifts in the leased premises. But this was not couched in sufficiently clear terms in the lease to create a positive obligation, enforceable by the tenant.

In another claim, a third party's rights of access to the tenanted land was expressed in ambiguous terms, generating a dispute about the kind of access contemplated by the wording of the lease.

Where the landlord assumes extra obligations during the initial term of a lease, (for example, to cover fit-out costs or providing a rent-free period), be careful to ensure that these are not inadvertently carried into future terms.

Outgoings

In claims concerning leases, a common error is the omission of owners corporation outgoings.

If the *Retail Leases Act 2003* (Vic) (the Act) applies:

- Ensure that the minimum amount of detail required for recovery of outgoings is included: see section 39. That is, specify:
 - » the outgoings that are recoverable;
 - » how the outgoings will be determined and apportioned (ensure the method is consistent with the *Retail Leases Regulations 2003*); and
 - » how the outgoings are to be recovered.
- Make the lease definition of outgoings conform to the definition in the Act: section 3.
- Exclude recovery of prohibited items such as undisclosed fit-out costs, capital costs, depreciation, contribution to sinking funds, interest on borrowings, head lease rents, land tax: sections 20, 41-45, 50.
- Adopt the correct method of apportionment by multiplying the total amount of the outgoing by the relevant fraction as set out in the *Retail Leases Regulations 2003* (regulation 10).
- Be conscious of the limitations on recovery of management fees: section 49.
- Ensure the provisions concerning statements of estimated and actual outgoings conform to sections 46, 47, 48.
- Be aware that for premises located within shopping centres, operating expenses need to benefit a tenant's premises before the tenant may be required to contribute: section 40.

2. Options

Missed and misunderstood dates for the tenant to exercise an option are a common source of claims.

A missed opportunity to exercise an option can be an expensive oversight, with major financial implications for a tenant forced to relocate its business.

Failure to exercise an option

These claims continue to occur mainly as a result of oversight or poor engagement management.

Typically, a lease requires the tenant to exercise an option for a further term in writing and within a specified period of time. Claims can arise from a number of circumstances:

- The client telephones the solicitor shortly before the period is to expire for exercising the option. The solicitor either fails to act at all or, fails to ensure that the notice is dispatched within the required period.
- The client claims not to have been advised of the cut-off date for exercising the option or the necessary steps to be taken.
- It is alleged that the solicitor undertook to contact the client for instructions prior to the option expiring.
- The option is exercised but not in the manner prescribed by the lease.

For example:

- » The lease requires that the current option be exercised in writing and sent to the registered office of the landlord. The landlord's registered office has changed and the letter is sent to the old address close to the deadline and the landlord declines to accept the exercise.
- » The lease requires notice to be given to the landlord but notice is purported to be given to the solicitors who acted for the landlord at the time the lease was entered into.
- When acting for a sub-tenant, the sub-lease prepared does not impose an obligation on a sub-lessor to exercise an option for the head lease thus rendering any option available to the sub-tenant useless.

When sending the stamped lease to the tenant, we recommend that the tenant's solicitor advise:

- the time for exercising the option;
- the consequences of failing to exercise in time; and
- that the solicitor accepts no responsibility for reminding the client to exercise the option in time and that the tenant must set up its own internal reminder system.

Rent-free period carried over

We have seen a number of cases with the rent-free period offered at the outset of the lease unwittingly carried over into the option. This can happen where the option is stated to be on the same terms as the original lease. You need to ensure that special or one-off terms contained in the original lease are not inadvertently drawn into further terms of the lease.

Mortgagee consent

Solicitors are often unaware that by exercising an option to renew a lease, the client is entering into a new lease, requiring a fresh consent from the mortgagee.

Options and the *Retail Leases Act*

Section 28 of the *Retail Leases Act 2003* (Vic) places an obligation on the landlord to notify the tenant of the last date for the exercise of an option to renew **not more than 12 nor less than 6 months** before the last date for the exercise. If the Act applies, the landlord's solicitor should inform the client:

- of this obligation;
- the consequences of failing to send the notice in time (ie. the lease continues and the option is exercisable until 6 months after the notice is given); and
- that the solicitor accepts no responsibility for reminding the client of the time to send the notice and the landlord will need to set up its own internal reminder system.

It is worth noting a recent Supreme Court decision that interpreted the notification provisions in section 28 very strictly: *Xiao v Perpetual Trustee Company Ltd & Anor* [2008] VSC 412. The Court interpreted section 28 (1) to require physical supply of the notice and 'evidence that it is actually provided and received': in practical terms this is akin to personal service. If your landlord client chooses to put the issue of notification beyond doubt, they may opt to pay for the notice to be personally served.

A landlord does not have to give notice if the tenant has exercised or purported to exercise the option before receiving the notice.

In cases where there is no option to renew, section 64 of the Act requires that notice of the landlord's intentions concerning renewal be given **not more than 12 nor less than 6 months** before the lease term ends:

- offering the tenant renewal on specified terms; or
- informing the tenant that renewal will not be offered.

Failure to give notice has consequences similar to the consequences that flow from a failure to give notice under section 28 — term of the lease continues.

Disclosure on renewal

Under the *Retail Leases Act 2003 (Vic)*, disclosure on renewal is required **at least 21 days** before the term ends in the case of an option for renewal and **within 14 days** after agreement to renew where there is no option: section 26(1).

3. Rent review

Claims concerning rent review typically involve a failure by the solicitor to:

- clearly advise who is entitled to trigger the rent review clause and when; and
- properly document the rent review formula.

Mathematical mistakes are often made in rent review clauses. It is prudent to get someone other than the person who drafted the document to check that the figures convey the meaning intended by both parties. Where the figure payable relies on a percentage or a formula, perform test calculations to ensure the result makes sense for the life of the lease and is what your client wants.

Retail leases

The statutory regulation of rent review clauses under the *Retail Leases Act 2003 (Vic)* and its predecessors* has been a perennial source of claims.

In the past, claims arose because of threshold failures: solicitors failing to appreciate the client's premises were retail premises and therefore preparing a void rent review clause. Solicitors are now better at identifying retail premises and determining when the Act applies, but still slip up with clauses that are ambiguous or breach the rules governing rent review in the Act.

The Act prohibits clauses that purport to say the rent review must exceed or be not less than the rent payable before the review (known as an underpinning or ratchet clause).

Section 35 of the *Retail Leases Act* provides that only one of the following rent review options may be used at any one time:

- a fixed percentage;
- an independently published index of prices or wages;
- a fixed annual amount;
- the current market rent of the retail premises; or
- another basis or formula prescribed by the regulations.

Section 35(3) provides that any review clause other than types in the first three options above, is void to the extent that it attempts to limit or prevent a reduction in rent.

Market underpinning or ratchet clauses

Commercial leases

Solicitors should be aware that since 2007 the LIV standard form Commercial Lease no longer has an underpinning clause. This means that there is no 'floor' in the current standard form, so rent may fall. For commercial leases, ensure you always address the issue of underpinning with your landlord clients.

Retail Leases

As outlined above at page 9, the *Retail Leases Act* prohibits ratchet clauses and underpinning.

* Prior to the *Retail Leases Act 2003* (Vic) under the *Retail Tenancies Act 1986* (Vic) and the *Retail Tenancies Reform Act 1998* (Vic).

4. Assignments

Claims can arise where the client has purchased a business and entered into possession without first obtaining an assignment of the lease of the premises.

Clients are often so keen to enter into the business that they are not prepared to wait for the assignment of a lease to be finalised, as it seems to be a minor formality. The issue is also covered in the companion risk management booklet *Small Business, Big Risks*.

EXAMPLES:

Business without a lease

The contract of sale was for chattels of the business and not the goodwill. Settlement was delayed because no assignment of lease was provided. The tenant's solicitor advised the client not to enter into possession of the business until an assignment of lease or a fresh lease was obtained. The solicitor did not confirm the advice in writing or keep file notes of the conversations.

The client insisted upon entering into possession and the solicitor therefore prepared a management agreement. The client soon found that the business was not profitable and attempted to sell it. The client then blamed the solicitor because he was unable to sell the business without a lease.

Problems with original lease

The purchase of a business was conditional upon obtaining an assignment of a lease. There was a problem with the original lease that resulted in delays in obtaining the assignment. The delays were so long that the business was being run down. The client blamed the solicitor for not having picked up the problem with the original lease.

Variations not taken into account.

Acting for a shopping centre tenant, the solicitor was involved in negotiating variations to the exclusivity and 'permitted use' terms of a retail lease following an argument with another tenant. The solicitor went on to act for the same tenant in an assignment of the lease, but failed to disclose the variations. The solicitor had not stopped to ask the question: is there anything in the recent history of this lease relevant to the assignment? This might have required searching and reviewing a separate though related file.

Guarantees

When a lease is being assigned to a company, it is important to ensure that the landlord obtains a guarantee from the assignee's directors.

Assignment under *Retail Leases Act*

Disclosure

The assignor tenant must discharge various disclosure obligations under section 61(3) of the *Retail Leases Act* 2003 (Vic) (the Act). This involves giving the proposed assignee a copy of the disclosure statement originally given to the tenant together with any changes that the tenant ought to be aware of. This may involve requiring the landlord to provide an updated disclosure statement for this purpose: see section 61(5).

If the assignment relates to premises to be used for an on-going business, the tenant must also give both the landlord and the proposed assignee a disclosure statement (section 61(5A)). Provision of the disclosure statement before the assignment will release the tenant and its guarantors from liability in respect of amounts payable by the proposed assignee under the lease so long as the statement does not contain information that it false, misleading or materially incomplete: section 62.

See 7. The *Retail Leases Act* at pages 16-17 for further discussion on disclosure.

CHECKLIST

The departing tenant's obligations are to:

- request the landlords' consent to an assignment: section 61(2)
- provide the assignee with the disclosure statement (previously given to the tenant and any changes the tenant should be aware of regarding the lease or request an updated version from the landlord): section 61(3)
- in the case of an ongoing business, also give the landlord and the proposed assignee the disclosure statement required by section 61(5A).

5. Directors' guarantees

Where a tenant is a company, directors' guarantees can protect the landlord's position so that, in the event of a default, the client can look further than a two-dollar company for recovery.

Solicitors should be aware of the range of possible errors concerning directors' guarantees:

- Failing to advise the client of the desirability of obtaining the guarantees.
- Forgetting to obtain the guarantees at all, never having prepared them.
- Preparing the guarantees, sending them out to the tenant or the tenant's solicitors but never receiving the executed guarantees back. *Remember that the tenant's solicitor is going to be the last person to remind you that you have not got them back.*
- Sighting the directors' signatures next to the company seal on the lease and believing that the guarantees have been executed.
- Overlooking the need to obtain fresh guarantees on the exercise of an option under an existing lease.

The other areas of potential trouble are:

- Clause 15.2.2 of the Law Institute of Victoria copyright lease states that the liability of the guarantor is not affected by the failure of any guarantor to sign 'this document'. This seems to be intended to address the situation where two or more persons are named as guarantor but not all of them sign with the result that only those who do sign are liable.

The execution page states that the guarantor agrees to be bound by the guarantor's obligations set out in the lease. However, the execution page does not contain any sub-heading providing for execution by the guarantor. Provision must be made for execution by all named as guarantor.

It is essential that the guarantor sign specifically in his or her capacity as guarantor. Clause 15.2.2 would not render the guarantee enforceable against a guarantor who has not signed.

- The need to discuss with the client whether a security deposit or a bank guarantee should be obtained.
- When a lease is being assigned to a company, it is important to ensure that the landlord obtains a guarantee from the assignee's directors.

6. Mortgagee's consent

Claims arising from the failure to obtain the mortgagee's consent appear to be linked to the economic cycle and tend to arise more frequently during economic downturns.

The consequences are disastrous for a tenant client when the bank moves in to take possession of the premises, leaving the client with no premises and a business of little or no value.

Claims arise for a range of reasons:

- Some solicitors are simply unaware of the need to get the mortgagee's consent; no problems arose in the past so long as the clients' landlords remained solvent.
- Other solicitors do not obtain a title search of the property, accepting the landlord's word that there is no mortgage. We have seen cases where the tenant client and our insured solicitor relied on the landlord's representation that the property was unencumbered, but a later search revealed otherwise.
- A solicitor can become distracted by other aspects of the transaction and, while the mortgagee may have been in communication with the tenant's solicitor, or even be aware that the tenant intends to take a lease of the premises, the mortgagee's formal consent is never obtained. The solicitor may wrongly assume that because the mortgagee is on notice of the client's impending tenancy, there is no need to obtain written consent.
- A client acquiring a business may ask the solicitor to do nothing more than peruse the lease. Or a client may instruct the solicitor to negotiate terms of the lease and leave saying he or she will deal with the execution of the lease. Years later the client returns, having been evicted by the mortgagee.

Even on the most limited retainer, the client must be warned of the need to obtain the mortgagee's consent.

Clause 6.3 of the Law Institute of Victoria copyright lease provides that the landlord must give the tenant written consent to the lease from all relevant mortgagees. However, the clause can only be enforced after the lease has been entered into.

The clause is of little use to the tenant if the mortgagee refuses consent. The tenant client should be informed that in order to fully protect its interests, the consent must be obtained before the tenant enters into the lease.

Solicitors also need to be aware:

- Some forms of mortgagee consent require a fresh consent on renewal, assignment or other dealing affecting the lease.
- Some consents are virtually worthless because of the qualifications contained in them. For example, a consent may be expressed to be operative only so long as the tenant is not in default under the lease.

Where the mortgagee refuses to provide formal written consent before the lease is executed, solicitors should ask for a 'specimen of consent': a draft or proposed consent that the mortgagee intends to give. This allows the proposed tenant to see the terms of the consent and puts the mortgagee on notice of the proposed tenant's interest.

7. The Retail Leases Act

In the past, LPLC has seen many claims in the area of retail leases as a result of the introduction of previous retail leasing legislation (*Retail Tenancies Act 1986 (Vic)* and *Retail Tenancies Reform Act 1998 (Vic)*).

Under the current *Retail Leases Act 2003 (Vic)* (The Act), the area attracting most claims is non-compliance with the disclosure requirements.

Disclosure requirements

Failure to comply with the disclosure requirements can result in the tenant having the right to terminate. Claims against solicitors acting for landlords arise where the formal disclosure requirements are not met. Solicitors acting for either landlord or tenant must be able to recognise when a landlord is in breach of the disclosure requirements in order to advise clients on the rights flowing from a possible breach.

Claims are still generated in small numbers by threshold failures to provide disclosure statements. In a second generation of claims we have seen deficient disclosure statements and arguments between the parties about what the disclosure statement means.

EXAMPLE:

In one claim, assumptions were made by both parties that the planning permission had been sought and granted for use of premises as a bar and restaurant. On the disclosure statement the landlord confirmed that it had obtained planning approval for any renovations, redevelopments or extensions of the building. Nothing was disclosed about the liquor licence because it assumed the tenant was taking care of this. The prospective tenant later argued that the disclosure about planning approval suggested that approval had also been obtained for a 3am liquor licence. In fact, neither party had attended to the late licence and the parties had not clearly communicated with one another on the issue. This misunderstanding was generated by poor communication between the parties and gave rise to a dispute about the meaning of the disclosure about planning approval.

The updated Retail Leases Information Brochure which must be provided by landlord to tenant when negotiating a new retail lease is available at www.sbc.vic.gov.au/retail-leasing-matters.

The new guidelines under the *Retail Leases Act 2003 (Vic)* about current market rent and engaging specialist valuers are available at www.sbc.vic.gov.au/retail-leasing-matters.

Appendix One of this booklet sets out a table summarising the disclosure requirements under the *Retail Leases Act* as a general guide. Solicitors are encouraged to read the Act carefully.

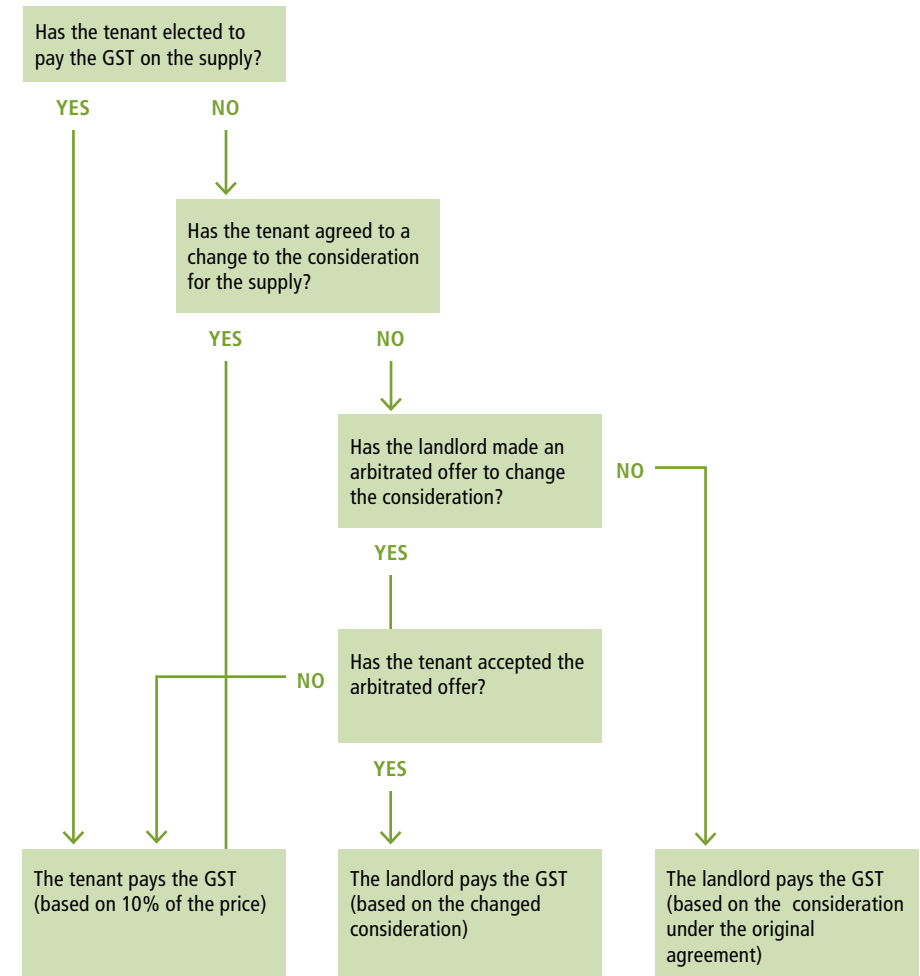
8. GST and leases

The transitional treatment of contracts spanning 1 July 2000 under *A New Tax System (Goods and Services Tax Transition) Act 1999* ('Transition Act') came to an end on 30 June 2005; however, the Transition Act was amended by the *Tax Laws Amendment (Long-term Non-reviewable Contracts) Act 2005* which provided for a system of arbitrated offers for use by parties to determine how the GST was to be borne and whether the consideration was to be adjusted to take account of the supplier's burden.

The GST treatment of leases is now reasonably well-understood but there are a number of aspects about which there is confusion and which are the subject of enquiries to the LPLC GST Hotline:

- 1 The reimbursement or payment of outgoings by a tenant is treated as part of the consideration for the supply of the premises, in the same way as rent.
- 2 The reimbursement of an outgoing (e.g. council or water rate) that, in itself, is GST-free or GST exempt, will still be treated as part of the consideration for the grant of the lease and attract GST if the supply of the premises is taxable.
- 3 The payment direct to a rating authority of an amount for which the landlord is ultimately liable (e.g. rates) is treated as a reimbursement.
- 4 The payment or reimbursement of a landlord's legal costs is treated in the same way as rent or the reimbursement of any other outgoing under the lease and so part of the consideration for the supply of the premises. Accordingly, if supply of the premises is taxable, the landlord must give the tenant a tax invoice for the costs reimbursement; it is not sufficient for the landlord's solicitors to give the tenant their own tax invoice.

LONG-TERM NON-REVIEWABLE LEASES: TAXABLE SUPPLIES ON OR AFTER 1 JULY 2005



9. Land tax

Section 50 of the *Retail Leases Act 2003* (Vic) prohibits the recovery of land tax from the tenant. However, claims can still arise in relation to leases that are not subject to the *Retail Leases Act*, usually where the solicitor fails to determine the basis on which land tax is payable.

EXAMPLES:

Tenant's complaint

The lease provided that land tax was payable to the landlord, but failed to provide it was payable on a single holding basis. The tenant's solicitor was either unaware that the wording meant that land tax would be payable on a multiple holding basis, or failed to draw the client's attention to liability for the tax on a multiple holding basis.

Landlord's complaint

The landlord complained that it had not been advised about the basis upon which land tax was calculated when a new lease was granted. The lease provided for the land tax payable by the tenant to the landlord to be calculated on a single holding basis whereas the landlord claimed that it wanted it to be calculated on a multiple holding basis.

LIV lease

Solicitors also need to be aware that the Law Institute of Victoria copyright commercial lease provides for land tax to be included as part of the outgoings paid by the lessee calculated on a single holding basis unless the *Retail Leases Act* applies.

Land tax may be recovered by the landlord on retail leases that predate July 2003, but section 121(2) of the *Retail Leases Act* outlines the procedures to be complied with.

Emerging risks

1. Stamp duty on leases

The *Duties Act 2000* (Vic) has been amended by the *Duties Amendment Act 2009* (Vic). While the amending Act received royal assent on 7 July 2009, the changes took effect from 21 November 2008. For transactions that are affected by the changes and occurred between 21 November 2008 and 7 July 2009 there is a moratorium on penalty tax and interest until 7 October 2009.

While the amendments target the avoidance of duty in leasing arrangements where a change in beneficial ownership occurs, as drafted, they appear to catch many leasing arrangements beyond the 'change in beneficial ownership' scenario.

What has changed?

The most significant amendment is the change to the imposition of stamp duty payable on leases. Subsection 7(1)(b) of the *Duties Act* lists the transactions for which duty will be charged. The new subsections 7(1)(b)(v) and (va) are:

- (v) the granting of a lease for which any consideration other than rent reserved is paid or agreed to be paid, either in respect of the lease or in respect of:
 - (A) a right to purchase the land or a right to a transfer of the land;
 - (B) an option to purchase the land or an option for the transfer of the land;
 - (C) a right of first refusal in respect of the sale or transfer of the land;
 - (D) any other lease, licence, contract, scheme or arrangement by which the lessee, or an associated person of the lessee, obtains any right or interest in the land that is the subject of the lease other than the leasehold estate;

- (va) the transfer or assignment of a lease for which any consideration is paid or agreed to be paid, either in respect of the transfer or assignment or in respect of:
- (A) a right to purchase the land or a right to a transfer of the land;
 - (B) an option to purchase the land or an option for the transfer of the land;
 - (C) a right of first refusal in respect of the sale or transfer of the land;
 - (D) any other lease, licence, contract, scheme or arrangement by which the transferee or assignee, or an associated person of the transferee or assignee, obtains any right or interest in the land, that is the subject of the lease other than the leasehold estate;

On a literal interpretation of subsection (v) above, duty will be chargeable on the granting of **any lease for which there is consideration other than rent reserved (for example, a lease in relation to which a premium is payable)**. The lease will be dutiable if the consideration, other than rent reserved, is paid in respect of either the grant of the lease, or any of the events listed in (A) to (D). It may not be necessary for the lease to contain any of the rights or options referred to in (A) to (D) to attract duty. Consideration may include non-monetary consideration and there is no restriction on the type of lease, so it could include residential, commercial or retail.

'Rent reserved' is defined in section 3 to be 'the rent paid or payable during the term of the lease and any amount paid or payable for the right to use the land under the lease'. An example is given and includes rates, charges, taxes, maintenance, utilities, legal costs required to be paid by the lessee on behalf of the lessor in relation to the grant of the lease, insurance premiums, marketing costs and car park contributions. While the example is helpful it should not be read as an exhaustive list.

Similarly, subsection (va) provides that stamp duty will be payable on **any transfer or assignment of lease for which any consideration is paid or agreed to be paid**. Any monetary or non-monetary contribution made to facilitate a transfer or assignment will arguably make the transaction dutiable.

Are there any exemptions?

There are exemptions for leases, assignments, transfers and surrenders of leases in relation to retirement villages (see subsection 7(3AA)). Under a transitional provision, leases entered into before 21 November 2008 which provided for an option for renewal and required extra consideration to be paid in order to exercise that option are also excluded from the scope of the new provisions (see subsection 7(3AAB)).

The same exemptions which exist for transfer duty will also be available for these lease transactions (as these lease transactions are now another type of 'dutiable transaction').

What duty is payable?

The stamp duty payable in respect of leases or transfers or assignment of leases in section 7(1)(b)(v) and (va) is assessed on the greater of the amount of consideration (or value of non-monetary consideration) other than the rent reserved that is paid or the unencumbered value of the land that is the subject of the lease (subsection 20(3)).

This is the particularly serious aspect of these amendments; where a lease is granted, or assigned, though even nominal non-rent consideration is paid, the duty payable will be calculated by reference to, not the consideration for the lease, but the market value of land at the time of the lease (or assignment of the lease).

What should practitioners do?

Practitioners who do any leasing work should carefully read all of the recent amendments to the *Duties Act*.

When handling a lease transaction (including assignment and transfers) carefully assess whether there is any consideration being offered other than rent reserved and if so advise the client of the possible broad interpretation of the new amendments. Clients should be advised that:

- if there is any concern about whether duty will be payable they should seek a private ruling from the State Revenue Office and then have the lease, transfer or assignment denoted not dutiable.
- the risk of not having the lease properly stamped include:
 - » being unable to have the lease registered on title; and
 - » being unable to have the lease produced in court as evidence in the event of a dispute between landlord and tenant (or with any other party); and
 - » having to pay penalty tax and interest if stamped late.
- State Revenue Office rulings provide limited certainty but are not binding on the SRO. As such, rulings have no status before a court: it is the correct interpretation of the legislation which will be decisive if a dispute goes to court.

Record all oral advice in a file note, including any reasons the client gave for wanting to proceed with the transaction, and confirm all advice in a letter.

Emerging risks

2. Documentation of lease incentives

Solicitors for both landlords and tenants should give clients clear advice about the risks inherent in the practice of landlords requiring lease incentives to be documented outside the lease document.

The practice has crept into Victoria, probably originating from jurisdictions with mandatory registration where lease incentives were recorded outside the lease to maintain their confidentiality. In Victoria, leases are not generally registered, so the confidentiality justification does not hold true.

Treatment of incentives outside the lease has potential for causing mischief, for example:

- A purchaser of the property agrees to pay a price based on the apparent or 'face' rent rather than the real or 'effective' rent.
- A mortgagee of the freehold makes an advance against the security of the property which is based on the face rent rather than the effective rent.
- A mortgagee of the freehold consents to a lease on the basis of the face rent.

Acting for landlords

Solicitors should discourage their landlord clients from documenting a lease incentive separately from the lease. Landlord clients should be given appropriate written warnings about the risk of misleading a third party about the rent actually payable under the lease.

Where the landlord client declines this advice, the solicitor should ensure the risk is transferred back to the client. This can be achieved by explaining in writing that the incentive must be disclosed to any third party, such as a purchaser or mortgagee who might otherwise be misled as to the rent payable under the lease.

Acting for tenants

Solicitors acting for a tenant who are asked to agree to the lease incentives being documented outside the lease document should advise the client that there is a risk that:

- the mortgagee may not be told about the 'lease incentive side arrangement' and if the mortgagee took possession of the property it would be difficult to insist that the side arrangement be honoured;
- any purchaser of the property may not be told about the side arrangement and again could argue that it is not required to honour the arrangement.

This advice should be confirmed in writing.

LPLC Leases Checklist

Although this is not a comprehensive checklist, working through it will help you to avoid the most common mistakes made in lease transactions. The checklist can be photocopied for ongoing use.

CLIENT

MATTER

Preliminary

- Search title to check landlord's name and to see whether the property is **mortgaged**.
- Where tenant is a company, do a company search to check the tenant's correct name and the **identity of all directors**.
- Exchange letters** between the parties confirming what has been agreed (let your client confirm the contents before it is sent).
- Consider whether the premises are **retail premises** as defined by the *Retail Leases Act 2003* (Vic).

General

- Advise the client to obtain **directors' guarantees** where the tenant is a company.
- Check that the guarantees have been **properly executed**.
- If the property is mortgaged, ensure that the **mortgagee has consented** to the lease in writing and that the consent is in acceptable terms. Require a specimen of consent if the mortgagee won't give a signed consent before the lease is executed.
- Consider whether there has been an **alteration to the terms** of the lease, requiring a fresh consent from the mortgagee or fresh guarantees from the directors of the tenant company. If so, ensure that these are obtained.
- If a security deposit or **bank guarantee** is to be provided, do not overlook obtaining it.

- Check that an **assignment of lease** has been obtained before the tenant client enters into possession. Make it a condition of the purchase of the business. Advise a tenant client in writing of the risks of taking possession without an assignment.
- In non-retail leases check whether the **land tax** is recoverable from the tenant and, if so, is it going to be calculated on a single holding or multiple holding basis?
- Advise the tenant client, in writing, of the need to **exercise any options** and exactly how to go about it and that you will not be responsible for reminding the client of the time for exercise.
- Ensure that the **notice to quit** is either dated and served the same day or undated with the time in which to vacate calculated from the date of service.
- Ensure the method of **rent review** is clear and unambiguous, including who may trigger it.
 - Is the date of review clear?
 - Does it make sense taking into account option periods?
 - Have test calculations been run through the rent review formula?
- Check that the liability for **all outgoing**s has been accounted for. Have owners corporation charges been dealt with?
- Include **appropriate** GST provisions:
 - stating whether the consideration is inclusive or exclusive of GST;
 - passing on the GST (if consideration is GST exclusive) to the tenant;
 - preventing the charging of GST on the GST component of outgoing;s;
 - entitling the tenant to a tax invoice at the time of payment; and
 - (if acting for the tenant) try to make the GST treatment reciprocal.

- Check that the version of the **lease to be executed** reflects the agreed terms and the client's instructions.
- Document all attendances and meetings with your client and others.
- Your file notes should:
 - be dated;
 - identify the author;
 - record the duration of the attendance;
 - record who was present or on the telephone;
 - be legible to you and someone else;
 - record the substance of advice given and the client's response/instructions; and
 - be a note to the file rather than a note to self.

If the *Retail Leases Act 2003 (Vic)* applies

- If acting for the landlord, check that a copy of the lease and **information brochure** has been provided to the prospective tenant.
- Has an adequate **disclosure statement** been provided?
- Do the provisions concerning statements of estimated and actual **outgoings** conform to the Act?
- Does the method of **rent review** conform to the Act?
- Check that the liability for all **outgoings** has been accounted for
 - Does the lease definition conform to the Act?
 - Have prohibited items been excluded?
 - Has the correct method of apportionment been adopted?
- Do the landlord's **repair** obligations conform to the Act?
- Do the **relocation** and other interferences provisions comply with the Act?
- Check that **refurbishment and re-fitting provisions** specify the nature, extent and timing.

- Do the **abatement and termination provisions** conform to the Act?
- If acting for the landlord:
 - send a copy of the signed lease to the tenant;
 - lodge the lease details with the Small Business Commissioner; and
 - check that any security deposit has been lodged in an interest-bearing account.
- Advise the landlord client in writing of the need to notify the tenant of the **last date for exercising the option** (or the landlord's intentions where there is no option) and that you will not be responsible for reminding the client of the time to serve the notice.

Appendix One

Table of disclosure requirements under the *Retail Leases Act 2003 (Vic)*

| APPLICATION | TIMING | FORM | SANCTIONS/RIGHTS |
|---------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| NEGOTIATIONS Section 15 | At start of negotiations | <ul style="list-style-type: none"> • Copy lease • Information brochure | 50 penalty units |
| NEW LEASES Sections 17, 18 | At least 7 days before entering into lease (s.17(1)) | <ul style="list-style-type: none"> • Disclosure statement in prescribed form: Schedule 1, Retail Leases Regulations 2003 Vic. • Copy lease | <p>NO DISCLOSURE</p> <ul style="list-style-type: none"> • Between 7 and 90 days after entering into lease, tenant may give written notice that a disclosure statement has not been provided (s.17(2)) • Having given the notice: Tenant may withhold rent until disclosure (s.17(3)) – no rent is attributable to period before disclosure (s.17(3)) Tenant may terminate before expiration of 7 days after disclosure (s.17(3)) <p>DISCLOSURE MISLEADING, FALSE OR MATERIALLY INCOMPLETE</p> <ul style="list-style-type: none"> • Tenant may terminate until 28 days after last to occur of disclosure, receipt of copy lease or entry into lease (s.17(5),(6)) <p>EFFECT OF NOTICE OF TERMINATION</p> <ul style="list-style-type: none"> • Termination occurs 14 days after notice of termination (s.18(1)) • Within the 14 days, landlord may challenge the termination (s.18(2)) |
| LEASE RENEWALS Section 26 | <ul style="list-style-type: none"> • In case of option, at least 21 days before term ends (s.26(1)) • Where no option but only agreement to renew, within 14 days after agreement made (s.26(1)) | Disclosure statement in prescribed form (same as for new lease) | Same as for failure to comply with disclosure requirements of s.17 (new lease) (s.26(3)-(6)) |
| ASSIGNMENTS Sections 61, 62 | <ul style="list-style-type: none"> • Before requesting consent, assignor to give assignee copy of disclosure statement and details of changes (s.61(3)) • Assignor may request landlord to provide disclosure statement current to within 3 months (s.61(5)) • In the case of an ongoing business, assignor must give landlord and assignee a disclosure statement (no time prescribed but not later than assignment) (s.61(5A)) | <ul style="list-style-type: none"> • Form previously given by landlord to tenant • Same form as for new lease • In the form prescribed | <ul style="list-style-type: none"> • Assignor liable to penalty of 10 penalty units (s.61(3)) • If landlord fails to comply, liable to penalty of 10 penalty units and tenant not obliged to comply with s.61(3) (s.61(5)) • No penalty provided but the assignor and guarantors would not be released from liability under s.62 |

Appendix Two

Other provisions under the *Retail Leases Act 2003 (Vic)*

Application

Solicitors need to be aware of the circumstances in which the *Retail Leases Act 2003 (Vic)* (the Act) applies and the consequences of non-compliance. For example, if a lease falls short of the 5 year minimum term, it is extended by virtue of section 21; if the landlord does not comply with the disclosure requirements, this gives the tenant the right to terminate.

- The Act applies to retail premises leases entered into or renewed after the Act commenced: 1 May 2003.
- Retail premises with occupancy costs equal to an amount prescribed by regulation (currently \$1million per annum) are exempt. Occupancy costs are defined in section 4(3).
- The application of the Act is no longer governed by size of floor area.
- Retail premises used only for the provision of services are not subject to the Act if the premises are wholly or partly on the fourth or higher storey of a building (excluding any basement levels) which is not in a retail shopping centre (Minister's determination 29 April 2003).
- Premises leased for 15 years or more where the lease requires the tenant to build or maintain the structure or plant and equipment and disentitles the tenant from removing them, are excluded from the Act (Minister's determination 20 August 2004). There is some controversy over the correct interpretation of this Determination.
- Franchises are no longer exempt.
- An exemption applies to listed corporations and their subsidiaries.
- There are other Ministerial Determinations exempting certain leases from the application of this Act (Barristers' Chambers Ltd, leases by Councils to not-for profit bodies and leases at Melbourne Markets).

Minimum term: section 21

- Leases must have a **minimum 5 year term** (taking into account any options) unless the Small Business Commissioner, at the tenant's request, certifies that an explanation has been given to the tenant and the tenant waives the application of the relevant section by delivering a copy of the certificate to the landlord.
- The extension operates in relation to the initial term only and does not alter any option for renewal. For example, a lease for a term of 2 years with an optional further term of 2 years would see the initial term changed to 3 years so as to provide the total minimum term of 5 years (taking into account the 2 year option).

Notify Commissioner of lease details: section 25

- When acting for a landlord you must notify (in writing) the Small Business Commissioner of certain details of the lease **within 14 days** of it being signed by all the parties. Failure to do so can result in a fine of 10 penalty units.

Unconscionable conduct: Part 9

- Part 9 of the Act deals with unconscionable conduct. The provisions repeat section 51AC of the *Trade Practices Act 1974 (Cth)* with three extra circumstances.

Security deposits: section 24

- Security deposits must be lodged by the landlord in an interest-bearing account on behalf of the tenant. Interest is added to the security deposit and the landlord must give the tenant details of accrued interest. The tenant will be liable for tax on the interest.

Fit-out

- Certain requirements apply whenever a tenant is required to pay or contribute to the cost of alterations connected with fit-out and the requirements are designed to set a limit on recovery: section 30.
- Until a landlord's fit-out is completed, rent and outgoings are not payable: section 31.
- A special rent may be charged to cover the landlord's costs of fitting out: section 32.

Repair (section 52)

- The landlord is under a specific obligation to repair. Urgent repairs are no longer capped at \$5,000.

Interferences with tenancy

- The tenant is still required to give notice of the loss or damage associated with an interference with the tenancy but this is not a pre-condition to an entitlement to compensation for interference: section 54.
- At least **60 days'** notice of refurbishment works which might adversely affect the premises must be given: section 53.
- Relocation provisions deal with clauses providing for termination accompanied by the offer of new premises and also the question of rent for the alternative premises: section 55.
- There is a two level compensation regime where a tenant is required to vacate premises intended for demolition, which depends on whether or not the demolition is carried out: section 56.
- An abatement and termination regime applies in relation to damaged premises: section 57.
- Refurbishment and re-fitting provisions are void unless they give details of the nature, extent and timing of the work to be carried out by the tenant: section 58.

Retail tenancy disputes (Part 10)

- Part 10 deals with disputes.
- Generally, (ie. except for injunctions) you cannot issue in VCAT unless the Small Business Commissioner certifies that mediation (or another form of ADR) has failed or is unlikely to resolve the dispute. VCAT is given the same jurisdiction as the Supreme Court to provide relief from forfeiture. Parties must bear their own costs in VCAT except where the proceeding is vexatious, a party has conducted the proceeding in a way that unnecessarily disadvantaged the other or refused to take part in a mediation.

Rent review: see pages 9-10

Assignments: see pages 11-12

This is not a comprehensive summary of the *Retail Leases Act*. Solicitors are encouraged to read the Act carefully.

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