

COMMERCIAL & RETAIL LEASING UPDATE

ISSUE 1, SEPTEMBER 2009

TENANT'S LOSS OF OPTION DUE TO DEFAULT

Many commercial and retail leases contain an option to renew. An option to renew is a unilateral right of the tenant to extend the lease if certain conditions are met (usually giving notice at the right time and non-default under the lease).

Some tenants have struggled to pay rent on time over the course of their lease and even at the time of exercising their option. This trend is likely to increase in the current climate.

Some landlords may not wish for an unreliable tenant to continue under the lease for a renewed term. This desire may be increased if there are enquiries from a more reliable/lucrative potential tenant or if the landlord wishes to do something else with the property.

Denying the option because of tenant default?

Many leases will make the exercise of the option conditional on "no default by the tenant".

Read literally, the text of some leases could mean that an ancient isolated minor default (which has subsequently been remedied) could remove the tenant's right to exercise its option.

To avoid this potentially harsh result leases in Queensland are governed by Section 128 of the *Property Law Act* which sets down certain steps before a landlord can prevent the exercise of the option because of a tenant's breach.

Section 128 of the *Property Law Act*

It will be an important business decision for the landlord as to whether they want to prevent the option exercise or alternatively, tolerate the unreliable tenant for a renewed term.

If the landlord wishes to "kill off" the option Section 128 of the *Property Law Act* places obligations on the landlord and gives the tenant an opportunity to seek to protect their option. It is important to note that there are critical timeframes for both the landlord and tenant.

A summarised chronology of events under Section 128 is as follows:-

- (1) The tenant purports to exercise the option by written notice to the landlord;
- (2) Within 14 days of the tenant's purported option exercise the landlord serves on the tenant a "Prescribed Notice" stating:
 - (i) The act or omission of the tenant; and
 - (ii) Subject to any Order of the Court under subsection 128(6) of the Property Law Act the landlord proposes to treat that act or omission as having precluded the tenant from exercising the option contained in the lease.

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- (3) If the tenant wishes to preserve its option it must bring court proceedings for Release Against Forfeiture within one month of the landlord's Prescribed Notice.

If the tenant does not apply for release against forfeiture within the required time the landlord will have successfully prevented the tenant from exercising its option.

On the other hand, if the tenant does commence proceedings in time the result will depend on the court's broad discretion.

Of course, a tenant should not wait until the final days of its time period to instruct a solicitor to proceed with the application.

Relief Against Forfeiture applications

The cases in this area show that Relief Against Forfeiture applications are often successful for tenants, even if there is a history of late payments, provided at the arrears or other breaches can be remedied.

On the other hand a more serious history of tenant's wilful, deliberate breaches of the lease and/or deception of the landlord is less likely to result in a decision in the tenant's favour.

A tenant deciding whether to commence proceedings must decide if the potential for a successful result is worth the cost of going to court to achieve it. Court costs will depend on the circumstances and amounts of money involved.

For example a small business tenant whose business is already struggling may simply accept that its option is lost, while a larger tenant with a more significant business investment and backing may deem it worthwhile (or indeed essential) to apply to court to preserve its option.

Proper legal advice essential

The purpose of this article has been to highlight the fact that Section 128 of the property Law Act exists and that there are important timeframes for the parties. This information will not usually be apparent by simply reading the lease.

Of course, there are numerous other important issues and considerations in this area of leasing law which are beyond the scope of this article.

We recommend that proper legal advice is obtained in relation to your particular circumstances at the relevant time. You should certainly not rely on this article as a substitute for legal advice

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If you would like to ask any questions about this or any other leasing issue Julian may be contacted on (07) 3221 1838 between 8:00am and 5:30pm Monday to Friday or on email jcreagh@quinnscattini.com.au

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