City of Sydney Law Society Lecture Series.

Presented by Craig Lambert, Barrister, 8th Floor Windeyer Chambers.

Topic: Circumstances that may constitute the surrender of a lease by operation of the law.

The Scenario (Names Omitted)

1. March 2012, the Client purchases a retail business located in a shop front in the CBD of Sydney.

2. The vendor of the business had previously entered into a registered lease with a term of 10 years expiring in 2018 and with initial rent of $110,000 per annum ex GST plus utilities and a fixed annual increase in rent of 4% per annum from the commencement of the lease in 2008.

3. The original lease is assigned in writing by the vendors to the Client with the consent of the Lessor and the transfer of the lease is registered.

4. In late 2015, the Client suffers health problems and this combined with lower than expected revenues and the rent of more than $13,000 per month causes the business to fail.

5. In mid-March 2016, the Client ceases to operate the business at the leased premises.

6. Other than the requirement to make good, the lease, not surprisingly, makes no provision for either termination prior to the expiration of the term or early surrender.

7. The extent of the rent owing for the remainder of the term is close to $330,000.

8. The Client's previous solicitor puts the Lessor on notice that the Client is unable to continue to operate the business in the leased premises and attempts to sublet the premises without success.

9. The Client's previous solicitor then attempts to negotiate an early surrender of the lease. The Lessor offers to accept $250,000 for the surrender of the lease.

10. The Client declines the Lessors offer and undertakes to continue to pay the rent until the lessor is able to find a new tenant.

11. The Lessor requests the Client provide access to the premises so that they might erect signage and that the Client execute an undated deed of surrender.

12. The Client's previous solicitor then requests the Lessor to market the premises at a lower rent offering for the Client to make up the difference between the rental paid by any new tenant and the rental due under the lease.

13. The Lessor rejects this offer and counters with an offer that the Client pay the net present value of the remaining outstanding rental immediately upon surrender and upon the expiration of the term of the lease the Lessor would refund 80% of any rent received from a replacement tenant.

14. The Clients attempts to find a purchaser for the business but negotiations with prospective purchasers fail and the Client offers the Lessor a one-off payment of $100,000 compensation for the remaining term of the lease in exchange for the surrender of the lease.

15. The Lessor reinstates his offer to accept a 25% discount on the net present value of the rent due on the remainder of the lease along with no make good cost to the Client or in the alternate the payment of the full net present value of the rent due on the remainder of the lease with 80% of any actual rent

received from another tenant less the cost of any make good to be refunded upon the expiration in return for the surrender of the lease.

16. The Client increases its offer of a one-off payment to $120,000 for the remaining term of the lease in exchange for the surrender of the lease.

17. Early June 2016 negotiations between the Lessor and the Clients previous solicitor breakdown. The Lessor affirms the lease is still on foot and demands payment of the continuing rent on time.

18. In mid-July 2016, the Client purports to restore the premises to the condition it was at the time the Client took possession by removing all stock and refrigeration equipment, hands back the keys to the Lessor by courier and ceases to pay rent thereby abandoning the premises and puts the Lessor on notice of the same and invites the Lessor to re-enter the premises and begin marketing the property.

19. In late July the Lessor, without appearing to have the assistance of a solicitor, informs the Client they cannot unilaterally terminate the lease, the Lessor has not and will not re-enter the premises, the lease remains on foot, the rent remains payable, the Lessor has no duty to mitigate the Clients loss and begins to bring pressure to bear for the Client to sign an undated deed of surrender.

20. The Client then engages a new solicitor who attempts to negotiate a deed of surrender with a proposed surrender date of the date of abandonment of the premises along with four month's rent rather than an undated deed of surrender as proposed by the Lessor.

21. The Lessor rejects the Clients offer and continues to affirm his position that the lease remains on foot, reserves its rights to bring an action for the Clients' breach of contract and maintains it is unable to market the premises whilst there is a subsisting lease and continues to press for an undated deed

of surrender on the basis that it will allow the Lessor to properly market the property to potential new tenants.

22. Between the period of early August 2016 in late October 2016 the Lessor without appearing to have the assistance of a solicitor, continues to maintain the Client cannot unilaterally terminate the lease, the Lessor has not and will not re-enter the premises, the lease remains on foot, the rent remains payable, the Lessor has no duty to mitigate the Client's loss and continues to pressure the Client to sign an undated deed of surrender.

23. In late October 2016, the Lessor provides a draft deed of surrender and between late October 2016 in the end of November 2016 refuses all requests from the Client's solicitor to amend the deed in any way, shape or form.

24. On 30 November 2016, the exasperated Client executes the undated Deed of Surrender ('UDOS') and forwards the same to the Lessor Landlord.

25. Inter alia, the UDOS provides for the following rather circular requirements:

Clause 1.1 "Clause 2 of this Deed is subject to and conditional upon the Lessor serving notice on the Lessee as provided for in Item 6;"

Clause 1.2 "Save as provided in clause 1.1 the provisions of this Deed shall take effect from the date of the execution of this Deed."

Clause 2.1 "The Lessee agrees to surrender its full right and title as Lessee in the Premises pursuant to the Existing Lease on and from the Surrender Date in Item 6."

Clause 2.2 "Subject to the Lessee meeting its obligations under this Deed, the Lessor agrees to accept the Lessee's Surrender of the Existing Lease on and from the Surrender Date."

Item 6 Defines the term Surrender Date as “The date nominated by the Landlord by notice in writing to the Lessee.”!!!!

Clause 3.3 “It is agreed that the Lessor shall **not owe any duty or obligation** to the Lessee to locate or secure a replacement tenant for the Premises within any particular time or at all nor shall the Lessor be under any obligation to accept any prospective or potential tenant for the Premises. The acceptance or otherwise of any particular tenant or terms of lease shall be matters within the absolute discretion of the Lessor."

26. And just to further protect the Landlord a little more Clause 3.4 requires the Lessee to specifically acknowledge “that (other than service of the notice referred to in Item 6) nothing done by the Lessor pursuant to or in connection with this Deed shall constitute a re-entry of the Premises or otherwise cause the Existing Lease to be terminated.”

27. In short, the Client is at the mercy of the Landlord until the Landlord nominates a surrender date which he presumably will not do until he finds a tenant that at his ‘absolute discretion’ he is prepared to accept.

28. On 17 January 2017, the Lessor demands payment of the last six months of rent in the amount of almost $100,000 whilst reserving the right to take legal action and advising that more than six weeks after the signing of the UDOS he is yet to appoint an agent to market the property.

29. On 26 February 2017, the Lessor advises that they have performed “*partial make good”* and appointed an agent who is allegedly *“very actively”* marketing the property. An investigation of the very active marketing by the Client’s solicitor reveals the extent of the marketing to be nothing more than signage being placed in the windows of the property.

30. Around this time, the Client's solicitor begins to form the view that the Lessor has been less than genuine in his promises to use his best endeavours' to market the property and the Client is at risk of the Lessor sitting out the term of the lease and accruing the outstanding rent as a debt due and payable and then enforcing it accordingly upon the expiration of the term.

Can the Undated Deed of Surrender operate in futuro where no date of surrender has been specified?

It is my opinion the question of whether a Deed of Surrender can operate *in futuro* is yet to be decisively determined by the High Court and the very few cases that deal with the concept of operation *in futuro* of a Deed of Surrender contradict each other.

In *Union Trustee Co of Australia Ltd v Baker* (1948) 65 WN (NSW) 247 the Court took the view that a Deed of Surrender that was expressed to commence operation two months after the execution of the deed was valid. It is to be noted however that in this instance the date on which the surrender was to take effect had been specified in the deed prior to the execution of the deed.

By way of contrast, in *Zorbas v McNamara* [1962] NSWR 52; 79 WN (NSW) 52 the Full Court of the Court of Appeal at 57 obiter observed:

> *"upon the execution of the deed of surrender the lessee's estate or interest, including the right of possession is extinguished."*

Although not binding the well research judgment of the District Court of Ontario in *Humphrey v. Ontario Housing Corp* 1979 96 D.L.R. (3d) 567 found:

> *"It would seem that a surrender must take effect at once and cannot operate in futuro. A review of Halsbury, 3rd edition, p. 683 and following indicates as follows:*
>
> *1412. Express surrender. A surrender of a term may be either express or by operation of law....*

1413. Form and effect of surrender. The surrender consists in the yielding up of the term to him who has the immediate estate in reversion in order that the term may, by mutual agreement, merge in the reversion(s). Hence the parties to the surrender must be the owner of the term(s) and the owner of the immediate reversion expectant on the term(s); and apparently the surrender must take effect at once; there cannot be a surrender in futuro(a); ...

The learned author goes on to consider the surrender by operation of law at p. 685. One of the footnotes on p. 685 refers to the case of Whitehead v. Clifford (1814), 5 Taunt. 518, as follows:

(k) Whitehead v. Clifford (1814), 5 Taunt. 518. Thus, there cannot be a surrender by a conditional agreement which is not followed by the tenant giving up possession ... nor can there be surrender by an agreement to give up and accept possession in the future."

This concept that it is the execution of the deed of surrender that extinguishes the tenant's estate or interest in the property thereby effectively rescinding the lease received approval by the High Court in the leading case of *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 at 48 where Brennan J., as he then was, held:

*"acceptance of a surrender by lessee who has repudiated a lease is **at once an acceptance of the repudiation and determination** of the lessee's interest in the land."*

The judgment of Brennan J. was followed in respect of the acceptance of a surrender constituting an immediate acceptance of the repudiation of the lease by the lessor was further affirmed in *Wood Factory Pty Ltd v Kiritos Pty Ltd* (1985) 2 NSWLR 105; [1985] ANZ ConvR 185[1].

[1] Per Samuels JA at 118

Although in Tasita Pty Ltd v Papua New Guinea[2], Young J in his inimitable style has held without more;

> *"The old myth that one cannot have a surrender in futuro seems to have been exploded in Union Trustee Co of Australia Ltd v Baker (1948) 65 WN (NSW) 247 at 249."*

In this case, the plaintiff argued that as a result of various conversations between its representative and a representative of the defendant there was a surrender of the lease by operation of law, or alternatively, the principle of estoppel produced the result that the leases had come to an end. Further and in the alternative the plaintiff claimed that under the Fair Trading Act 1987 it should be released from any further obligation to pay rent after the date of its vacation of the premises. It is to be noted that the plaintiff was successful on both legs of its claim.

With respect to the second leg of its claim Young J found:

> *"Thus, it seems to me that where one has a situation that a person makes a representation in circumstances where the Fair Trading Act 1987 would have prevented that person from benefiting from the misrepresentation had that person been affected by the Act, equity will ensure that that person does not obtain an unconscionable benefit through that misrepresentation."*

It is to be noted, that in this matter unlike in this scenario there was an actual date of surrender proposed in writing by the plaintiff and Young J. determined this matter not on the basis that there had been an effective surrender at law but rather on the basis that because of the representations made by the plaintiff's officer to the defendant that the plaintiff accepted the lease had come to end the plaintiff should thereby be estopped from denying that the lease had come to an end.

[2] (1991) 34 NSWLR 691

What constitutes a Surrender of the Lease by Operation of the Law

In *Andrews v Hogan* (1952) 86 CLR 223 at 252, Fullagar J citing the established authority of *Phene v Popplewell* (1862) 12 CB(NS) 334 at 340; 142 ER 1171 at 1174, held that the cases cited therein:

> *"show that much difficulty was felt about what constituted a surrender by operation of law. No mere abandonment of possession by the lessee could, of course, operate as a surrender. Any such abandonment must be accepted by the lessor, and the only way in which such an acceptance could be shown was by* ***proof of something in the nature of a resumption of possession by the lessor****. The difference between an "express" surrender and a surrender by operation of law seems indeed to have been the difference between an express agreement to give and take possession (which, after the statute, could only be proved by writing) and an agreement to give and take possession evidenced only by acts of the parties. So, in Phene v. Popplewell itself, (1862) 12 CBNS, at p 340 (142 ER, at p 1174), we find Erle C.J. saying: - "This mode of putting an end to a tenancy" - i.e. surrender by operation of law - "has undoubtedly been productive of much litigation from the time of Lord Ellenborough downwards. But I think the cases of Grimman v. Legge [1828] EngR 646; (1828) 8 B & C 324 (108 ER 1063) and Dodd v. Acklom [1843] EngR 1047; (1843) 6 M & G 672 (134 ER 1063) have put the matter upon a proper foundation:* ***anything which amounts to an agreement on the part of the tenant to abandon and on the part of the landlord to resume possession of the premises amounts to a surrender by operation of law".***

In *New Zealand Motor Bodies Ltd v Emslie* [1985] 2 NZLR 569 where it was held that at 603-604 Barker J held that:

> *surrender is effected once the lessee has vacated the premises with the intention of putting an end to the lease and the landlord has, by some* ***unequivocal act accepted that the lease is determined*** *(see 27 Halsbury's Laws of England (4th ed.) para 446)."*

And earlier in the judgment at 602 Barker J makes it clear that:

> ***"If after the lessee has quit the premises, the lessor re-enters, it would generally be presumed that by that act, he was showing an intention to accept the proposal implied in the abandonment of the lease.*** *However, where re-entry was accompanied by an express protest that the landlord was doing nothing of the kind, but only acting to do the best he could to prevent the destruction of the subject-matter of the contract for the benefit of both parties, the question was one of considerable difficulty….* ***The real issue was whether, in resuming possession, the landlord did anything more than was necessary for the purpose of preserving the subject-matter of the contract for both parties****."*

And in *Wood Factory Pty Ltd v Kiritos Pty Ltd* (1985) 2 NSWLR 105; [1985] ANZ ConvR 18 Priestley JA at 133 when laying out a summary of the relevant law with respect to surrender by operation of law held:

> *"Another situation under this heading comes about where the tenant abandons the premises without agreement with the landlord, in circumstances manifesting his intention to put the lease to an end, and the landlord does not retake possession until some time later. There are two varieties of this kind of situation; one of which results in a surrender, and the other of which does not: (i) Where the landlord, in retaking possession does so on his own account. This is the situation where Progressive Mailing has shown the legal result is different from what it was once thought to be. In Buchanan for example, it was taken for granted that a surrender by operation of law became complete upon the landlord taking possession on his own account and the landlord could not get damages for loss of the lease. Under the Progressive Mailing doctrine,* ***upon the landlord taking possession on his own account the lease still comes to an end (and the situation can still be called an example of surrender by operation of law as well as a contractual termination following accepted repudiation or breach of fundamental term)*** *but the landlord is entitled to any damages suffered by loss of the lease."*

What could be done to assist the Client to "escape" the Lease?

Leaving to one side the question of whether a surrender of a lease can operate in futuro and whether the execution of the UDOS by the Client at the insistence of the Lessor Landlord constituted *"an acceptance of the repudiation and determination of the lessee's interest in the land"*[3] forthwith, it is clear clause 3.3 of the UDOS in effect placed no obligation upon the Landlord to re-lease the premises during the term of the lease.

It is the Landlord's position that the lease remains on foot and that he has not entered and thereby taken possession of the property and whilst the lease remains on foot he is entitled to the rent which the law would say is continuing to accrue as a debt which will be actionable at the expiration of the term of the lease.

From our Client's point of view it is not so much a question of whether the Landlord is entitled to leave the property unleased for the remainder of the term of the lease (clearly, leaving to one side issues of misrepresentation, he is) but rather whether the Client can put the Landlord in a position whereby the recovery of the debt that is presently accruing might be at risk because the Client is able to show that the Landlord took constructive[4] possession of the premises from on 18 July 2016 when the Client removed their possessions, restored the property to its condition at the start of the lease and returned the keys or even entered into actual possession sometime thereafter.

There could be no doubt that the acts of our Client on 18 July 2016 constituted a repudiation of the fundamental terms of the assigned lease that evinced an intention on the part of our Client no longer to be bound by the assigned lease. On this basis, Counsel advised the Client's solicitor to write again to the other side and put to the other side the proposition that the Landlord, had obtained if not actual then

[3] *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 Per Brennan J at 48

[4] See Gorman v. Pye and Another (1951) 68 WN (NSW) 180 where Owen J held that a tenant handing over the only key she possessed and the landlord accepting it was symbolic of handing over possession and coupled with the Landlord later taking actual possession constituted constructive possession from that time.

constructive possession[5] of the premises in as much as the keys had been returned to them and they entered and removed shelving left by the Client from the premises and had allowed an agent to enter and display advertising material in the windows of the premises. It must be conceded that at that time the evidence that the Landlord had done anything other than to preserve the *"subject-matter of the contract"* presumably for the purposes of re-letting the premises on the account of our Client was not strong.

Counsel advised the Client's solicitor to also put position that the execution of the Undated Deed of Surrender in and of itself constituted acceptance of our Client's repudiation of the Lease on 18 July 2016 and therefore both surrender and determination of the Lease. Counsel also advised the Client's solicitor to, rather cheekily, include a Form 7 completed by the Client for the purposes of the Landlord registering of the surrender of the Lease in accordance with section 54 of the Real Property Act 1900 albeit that our position was that the surrender was by operation of law[6].

This letter evoked an immediate and threatening response from a large Sydney law firm seemingly quickly engaged to act on behalf of the Lessor refuting the assertions of the Client's solicitor and demanding our Client pay the Landlord/Lessor's costs in 'refitting' the premises and all rental amounts owing in arrears including service and utility costs which by the calculations of the Landlord's solicitor totaled more than $281,000 or they would immediately commence proceedings.

Most importantly however, in seeking to justify this amount the large Sydney law firm had annexed to its letter an Excel spreadsheet setting out the dates when the Landlord's contractors had entered the premises and the cost and nature of the works performed by the Landlord's contractors which was the not insubstantial amount of in excess of $30,000. Rather than being works to restore the premise to

[5] See Gorman v. Pye and Another (1951) 68 WN (NSW) 180

[6] See s. 54(1) of the Real Property Act 1900 that provides: "Whenever any lease which is required to be registered by the provisions of this Act is intended to be surrendered, **and the surrender thereof is effected otherwise than through the operation of a surrender in law** or than under the provisions of any law at the time being in force relating to bankrupt estates, the lessee and lessor shall execute a surrender of the lease in the approved form."

their original condition the works were clearly a refit altering the use to which the property could be put. It was this vital piece of information that turned the scales in favour of our Client.

On the advice of Counsel, in the letter in reply from our Client's solicitor to the large Sydney law firm representing the Landlord our Client's solicitor was able to put this new evidence back to the Landlord's solicitor. It could not be denied that the extent of the money spent by the landlord for the new fit out to the premises meant that not only could the landlord be said to have entered into constructive possession of the property but rather the landlord had taken actual possession of the property not necessarily *"for the purpose of preserving the subject-matter of the contract for both parties*"[7] and the Landlord had by this "*unequivocal act accepted that the lease is determined."*[8]

In other words, by the act of refitting the premises and thus the resumption of possession by the Lessor it was more likely than not that a court would find the Lessor had accepted the repudiation of the breach of the lease by our Client and in accordance with the contractual principles of anticipatory breach and repudiation the lease was determined from the time of the resumption of possession.

Unsurprisingly, the Landlord Lessor settled the matter very soon thereafter for a greatly reduced sum.

The Moral of the Story?

(1) A potential surrender of a lease at law turns on its' own facts and;

(2) Always be very circumspect what evidence you chose to reveal to the other side; and

(3) Always retain and listen to the advice of good Counsel.

Craig Lambert,
Barrister-at-Law,
8th Floor, Windeyer Chambers.

[7] *New Zealand Motor Bodies Ltd v Emslie* [1985] 2 NZLR 569 per Baker J at 602
[8] Ibid at 603 to 604

