

Property Update

July 2010

When is it reasonable for an assignment of lease to be withheld?

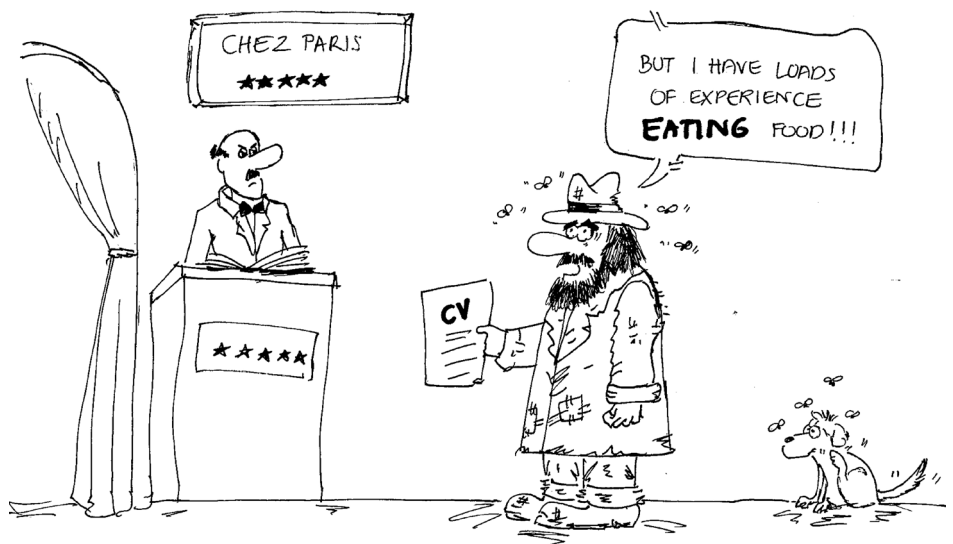
At a time when businesses are still recovering from the global financial crisis and uncertainty is still present in the market, many retail tenants are still seeking to assign their leases.

Taj Coffee Company Pty Ltd v Plaza Arcade [2009] WASAT 107, a decision of the State Administrative Tribunal, provides a valuable summary of the circumstances in which a retail lessor can reasonably withhold consent to an assignment of a lease.

The facts

The tenancy in question was a small coffee shop in Plaza Arcade, having an area of approximately 23m². The owner (and seller) of the coffee shop business had operated the business from the premises for 10 years. The business was primarily a take-away coffee shop, although limited seating was provided.

The business had been on the market for two years, as the seller was finding it difficult



to operate the business for health reasons and he was becoming increasingly reliant on assistants, which adversely affected the profitability of the business.

The seller's business broker found a prospective buyer. The seller applied to the lessor for an assignment of the lease.

The application was refused, on the basis of recommendations by the lessor's property manager that the buyer did not have enough retail experience to run the business and had not previously 'conducted successfully and profitably a business of the same type as the Lessee's business.'

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The Property Services Group, a division of Lavan Legal, pride themselves on being the leaders in property and planning law. Advising on all aspects of property acquisition, disposals and developments including syndications, we have one of the few accredited leasing experts available to clients who has significant Australia-wide experience on very large and complicated leasing developments.

At Lavan Legal we believe in building long lasting relationships with our clients. We provide the best legal advice and service and continue to improve our understanding of our clients' needs, staff, history, motivations and directions. We provide clients with regular industry insights, updates on changing technology and business strategies in an effort to take the relationship to a more successful position. We are committed to increased efficiency through continuous innovation and process improvement.

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The seller made an application to the State Administrative Tribunal to determine if the lessor's refusal to consent to the assignment of the lease was unreasonable.

The provisions of the lease and the Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA)

The application of the *Commercial Tenancy (Retail Shops) Agreements Act 1985 (WA) (Act)* to the lease of the premises was not disputed by the parties.

The relevant provision of the Act is section 10(1), which provides:

Notwithstanding any other written law, a retail shop shall be taken to grant to the tenant a right to assign a lease, subject only to a right of the landlord to withhold consent to an assignment on reasonable grounds.

The lease between the lessor and the seller provided as follows:

The Lessor must not unreasonably withhold its consent to a proposed assignment of the whole of the Premises to a proposed assignee if:

(ii) the Lessee proves to the Lessor that the proposed assignee is a respectable and financially responsible person or corporation with relevant experience and the ability to conduct successfully and profitably a business of the same type as the Lessee's Business.

Section 10(1) of the Act requires the State

Administrative Tribunal (**Tribunal**) to determine if the decision was 'reasonable' – that is, could a reasonable person have come to the same decision as the lessor did, on the same facts?

The parties' submissions

The seller

The seller claimed that the lessor should have paid more consideration to the buyer's commercial experience which, although not retail experience, was nevertheless valuable. The seller's argument was that the buyer had customer service experience in the information technology industry and his wife was an accountant. The seller also claimed that the size and entry-level nature of the coffee shop was so low that the buyer would not have any difficulty running it.

The seller stated that he also agreed to train the buyer for a four week period following settlement of the sale of the business and claimed that he had a 'system' which he would demonstrate to the buyer following settlement, which would ensure the viability of the business.

The lessor

The lessor expressed its concern at the buyer's lack of retail experience and the potential risk to the lessor if the business failed.

The lessor also stated that the buyer was given ample opportunity to explain the full extent of his retail and business experience but did not do so. On the basis of the information that was provided by the buyer,

the lessor considered that consenting to the proposed assignment would pose an unacceptable risk to the lessor.

The Tribunal's decision

The Tribunal ruled that the lessor's refusal to consent to the assignment was reasonable on the basis of the information the buyer had provided to the lessor. Specifically, the Tribunal found that the buyer did not provide enough information to the lessor to address the lessor's concerns that the business could fail due to the buyer's lack of retail experience. In particular:

- the business broker's evidence about the buyer's ability to run the business was not supported by any documentary or oral evidence by the buyer;
- the buyer did not provide any detail of the nature and extent of his business in the IT industry, and how that experience would apply to the management of a coffee shop;
- the buyer did not provide information about his wife's experience as an accountant;
- the buyer stated that his wife's family had been involved in the management of a coffee shop in Indonesia but did not provide any information as to why this was relevant to the proposed assignment; and
- the seller did not explain to the lessor the nature of the 'system' which would ensure the viability of the business following the change of ownership –

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the Tribunal did not accept the seller's argument that he did not disclose this information because it was a trade secret.

Finally, the buyer did not attend the Tribunal hearing. The Tribunal viewed this failure to attend as somewhat cavalier, and considered that it was 'a reflection of the relaxed way in which he approached the application'.

The Tribunal considered that the lessor had demonstrated that:

- it had taken into account all the information before it;
- there was logic to the decision; and
- the refusal to consent to the assignment was not arbitrary.

The relevant principles

The Act does not define what is meant by 'reasonable grounds'. During the second reading speech of the Act, the intention behind the words 'unreasonable grounds' was expressed as follows:

'...factors such as the financial record of the proposed assignee would be taken into account and its 'ability' ... The Landlord will obtain information about the credit rating of the proposed assignee and look at his previous business background...'

In making its decision, the Tribunal specifically stated that there is no statutory requirement for the proposed assignee's experience to be in the same industry.

Although more weight may be given to experience within the retail industry, this is not a requirement, and to assume the stance that the proposed assignee's experience must be in the same industry is a very strict and conservative approach.

The Tribunal also referred to the principles governing consents to assignments of lease in *EDWF Holdings 1 Pty Ltd and EDWF Holdings 2 Pty Ltd [2008] WASC 275*, which are derived from the High Court decision in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd (1979) 144 CLR 596*. In summary, these principles are as follows:

- the assignor has the onus of proving that the landlord's consent was unreasonably withheld;
- in order for consent to be withheld unreasonably, it must be withheld arbitrarily – without reasonable cause;
- whether or not consent was unreasonably withheld is a subjective question and the actual reasons for the refusal must be assessed in light of the information available to the lessor at the time the consent was refused;
- a party refusing consent does not have to give reasons for the refusal, although failure to provide reasons may suggest that the refusal was unreasonable;
- it is reasonable to refuse consent on the basis of a doubt based on reasonable grounds as to the assignee's willingness or ability to perform its obligations under the contract; and

- the refusal of consent to an assignment to a creditworthy lessee carrying on a lawful and permitted use can be reasonable if that refusal is made for reasons relevant to the lessor-lessee relationship, such as the tenancy mix in a shopping centre.

Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd (1979) 144

CLR 596 sets out the process which should be followed to determine whether or not the refusal of consent was reasonable. This begins with the court identifying the reasons for the refusal of consent. Once those reasons are identified, the court should determine:

- if they were objectively reasonable – that is, could a reasonable person have refused consent for these reasons;
- if they were relevant to the relationship between the lessor-lessee relationship; and
- if the facts on which the refusal was based were not erroneous.

If all of these questions are answered in the affirmative, then the assignor will have failed to prove that consent was unreasonably withheld.

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Lorraine is a solicitor in the property services group at Lavan Legal. She practices primarily in the areas of leasing and commercial property however she also has expertise more generally in corporate and commercial litigation, the acquisition and disposal of land and businesses, and general property law.

Lorraine's retail leasing experience includes the principal management of two major retail centres in Perth, and her industrial leasing experience includes acting for

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Her clients include Belmont Forum Shopping Centre, Burgess Rawson Pty Ltd, CB Richard Ellis Pty Ltd, Coxon Group of Companies, Colliers International (WA) Pty Ltd and Jones Lang LaSalle.

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