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How much is your foyer worth? Landlord's damages for tenant's breach of repair covenant

In *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* [2009] HCA 8, the High Court resolved a 12 year dispute by ordering the tenant to pay the landlord \$1,380,000 in damages for altering the building's feature foyer without first obtaining the landlord's consent. This case deals with how damages are calculated for breach of a repair covenant.

Facts

In 1997, the Bowen Investments Pty Ltd (“**Landlord**”) completed construction of the foyer of its office building at 5 Bowen Crescent Melbourne. It was of high quality and constructed with special materials including San Francisco Green granite. Tabcorp Holdings Ltd (“**Tenant**”) took possession of the property. The lease commenced on 1 February 1997 for a term of 10 years. An option to renew for 5 years until 2012 was exercised on 1 February 2006. There is a further option to renew for 5 years until 2017.

By clause 2.13 of the lease, the Tenant covenanted:

"Not without the written approval of the Landlord first obtained (which consent shall not be unreasonably withheld or delayed) to make or permit to be made any substantial alteration or addition to the Demised Premises".

The Tenant also covenanted to keep the premises in repair (cl 2.10), yield up the premises on the determination of the lease in good repair (cl 2.11), and to make good any breakage or damage (cl 2.12.4).

Six months after taking possession, the Tenant sought the Landlord's consent to alter the foyer. The Landlord informed the Tenant that it could not consent until it inspected the premises on 14 July 1997. When the Landlord attended the property on 14 July 1997, the landlord discovered that the Tenant was in the process of demolishing the fitout of the foyer and replacing it with its own design. The Tenant ignored the Landlord's protests and completed the new foyer on 31 August 1997. The Court noted that usually, a landlord would seek to obtain an injunction upon receiving notice of a threat to alter premises without consent. However, due to the “clandestine conduct” of the Tenant, it was not possible for the Landlord to obtain an injunction prior to destruction of the foyer.

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Trial

The Landlord commenced proceedings in the Federal Court of Australia. The trial judge found that the Tenant was well aware of this covenant and that it did not have consent. The trial judge found the Tenant had “contumelious disregard” for the Landlord’s rights.

The trial judge upheld a claim for common law damages in relation to two breaches by the Tenant of clause 2.13: the destruction of the foyer and the construction of the new foyer. He awarded damages in the sum of \$34,820, comprising the difference between the value of the property with the old foyer, and the value of the property with the new foyer, being the “diminution in value of the reversion [i.e. the property]” approach. The difference in value was as a result of reduced floor area available for use as office space. His implicit finding was the old foyer did not have more “pulling power” as a leasing tool than the new foyer.

The trial judge found that reinstatement costs will not be awarded unless there is some special interest in reinstatement. He accepted expert evidence that whether the lease was to end in 2012 or 2017, the Tenant’s alterations would cause very little diminution in the value of the building. He found that if the covenant had not been breached, the Landlord would have taken possession of the foyer after 15 or 20 years of wear and tear such that the foyer would probably have to be refurbished.

Appeal

The Landlord appealed to the Full Court of the Federal Court, disputing the basis on which damages was calculated. The Court held that damages for breach of clause 2.13 is assessed on the same basis as for breach of a repair covenant: is the cost of putting the premises into the state of repair required by the covenant (which is the “cost of reinstatement approach”).

The Court increased the judgment sum to \$1,380,000, comprising \$580,000 (cost of restoring the foyer to its original condition) and \$800,000 for loss of rent while restoration was taking place.

High Court

On appeal to the High Court, the Tenant sought restoration of the trial judge’s figure by arguing that the “diminution in value of the land” approach was correct. The appeal was dismissed and the assessment of damages at \$1,380,000 was confirmed.

In a unanimous decision, the High Court held that, in the absence of the Landlord giving its consent to the alterations, the Landlord was contractually entitled to have the foyer remain as it had been constructed. In altering the foyer without consent, the Tenant had breached its contractual obligation to maintain the foyer. The Court found that the appropriate measure of damages was the cost of restoring the foyer to the condition it would have been had the Tenant not breached its obligation.

Position in New South Wales

The finding of the High Court applies in states and territories in which there are no express statutory provisions to the contrary. In New South Wales, section 133A *Conveyancing Act* states the position in New South Wales in relation to damages for breach of a repair covenant as follows:

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“damages...shall not exceed the amount (if any) by which the value of the reversion (whether immediate or not) in the premises is diminished owing to the breach of such covenant...in particular no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown that the premises ... would at or shortly after the termination of the lease have been or be pulled down...”

In other words, it expressly states that the position in NSW is the method used by the trial judge – diminution in value of the reversion approach.

Summary

It is important for landlords with properties in different states and territories to be aware of how the quantification of damages varies from state to state, and what damages they are entitled to demand from tenants for breach of the repair covenant.

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