Landlord's repudiation by failing to repair and maintain: the decision in *Red Pepper Property Group Pty Ltd v S3 Sth Melb Pty Ltd* [2019] VSC 41 **Sam Hopper, barrister** **4 April 2019**	

1. This paper discusses:

   (a) the decision of *S3 Sth Melb Pty Ltd v Red Pepper v Red Pepper Group Pty Ltd* [2018] VCAT 1684;

   (b) the subsequent appeal of that decision in *Red Pepper Property Group Pty Ltd v S3 Sth Melb Pty Ltd* [2019] VSC 41;

   (c) their significance to property disputes;

   (d) their significance for property transaction lawyers; and

   (e) a '*sleeper*' issue that may be significant in the future.

S3 Sth Melb Pty Ltd v Red Pepper v Red Pepper Property Group Pty Ltd [2018] VCAT 1684

2. In the original decision of *S3 Sth Melb Pty Ltd v Red Pepper Property Group Pty Ltd* [2018] VCAT 1684, Deputy President Riegler held that a landlord's procrastination and failure to repair an air conditioning unit was a repudiation of the lease by the landlord, allowing the tenant to accept that repudiation, terminate the lease and sue for damages.

3. The tenant used the premises as a pilates and barre studio.

4. The lease contained clauses to the following effect (**emphasis** added):

1 Landlord works

(a) The Landlord must carry out and complete the following works to the Premises:

…

(xiii) ***<u>install air conditioning to service the Premises</u>****; and*

(xiv) The Landlord shall endeavour to complete all require [sic] Landlord works within a period of 8 weeks from either the date of the signing of the lease OR the date of the receipt of the bank guarantee required under this lease (whichever is the later),

(together, the ***Landlord's Works****).*

…

(e) In relation to the air conditioning units installed as part of the Landlord's Works (pursuant to special condition 1(a)(xiii)):

(i) the Tenant will at its sole cost, take out and maintain a maintenance contract for the Term (and any further term) with a reputable air conditioning service contractor to service those air conditioning units on a 6 monthly basis; and

(ii) subject to the Tenant's compliance with special condition 1(e)(i), the Landlord is responsible for any capital repairs associated with those air conditioning units.

5. The landlord did not install a new air-conditioning system, but used the existing system supply air-conditioning to the leased premises.

6. The tenant made various complaints about defects in the system. The complaints started around 23 May 2016.

7. After a terse exchange of emails and the commencement of VCAT proceedings, the tenant purported to accept the landlord's repudiation of the lease on 1 August 2017 and vacated the premises.

8. On or around 8 August 2017 the landlord asserted that the tenant had repudiated the lease and itself purported to terminate the lease.

9. Some time after the tenant vacated, the landlord's technicians diagnosed the problem with the air conditioning and had a new fan put it - a half hour job that fixed the problem.

10. The Tribunal found that the landlord was at fault.

11. **Firstly,** the Tribunal found that, on its true construction, the requirement to '*install air conditioning to* ***service*** *the Premises'* was a continuing obligation that carried with it an obligation to repair significant defects in the air-conditioning system.

12. **Secondly,** the Tribunal found that the landlord had been given notice of the need for repair and had failed to do so for some 10 weeks in breach of its repair obligations.

13. **Thirdly,** the Deputy President found that (emphasis added):

> *[70] In the present case, I accept Mr Norris-Ongso's evidence that air-conditioning was critical for the financial success of the Tenant's business. He said that clients were moving to other premises because the Premises could not be properly warmed during the colder months of the year. Although no data was provided evidencing the migration of clients from one fitness centre to another, I accept that it is likely that customers of a fitness centre require and expect a comfortable ambient temperature in which to work out.* ***Consequently, I find that the obligation to provide air-conditioning to service the Premises is a fundamental term of the Lease.***

[71] ***With that in mind, I further find that the refusal or failure to repair the air-conditioning system, if fallen into disrepair so that it cannot service the Premises, may constitute a repudiation of the Lease.***

…

[83] *Although I accept that some time should be afforded to allow the Landlord to engage its technicians to inspect the air-conditioning system and carry out repairs, 10 weeks is an unreasonably excessive period, especially so when compared to other occasions when the Landlord arranged for its technicians to inspect air-conditioning system after complaints were raised by the Tenant.*

…

[86] ***In my view, the failure on the part of the Landlord to do anything to make the air-conditioning system function, so that it serviced the Premises, after receiving written notice on 15 May 2017 until the Lease was eventually terminated on 1 August 2017, is a fundamental breach of the Lease****. It meant that the Tenant was effectively left without air-conditioning to service the Premises for more than two and a half months, before eventually terminating the Lease. This was an intolerable situation and, according to Mr Norris-Ongso, led to customers migrating to other fitness centres.*

[87] ***In my view, the Landlord's procrastination or non-performance would convey to a reasonable person in the shoes of the Tenant that the Landlord had disavowed itself of its obligation to repair the air-conditioning system, notwithstanding repeated requests being made*** *by the Tenant for the Landlord to honour its obligations under the Lease.*

> *[88]* ***Therefore, I find that the Landlord repudiated its obligations under the Lease and that the Tenant was entitled to accept that repudiation,*** *which it did by correspondence dated 1 August 2017. I find that the Lease came to an end on that day.*

14. This finding was significant because tenants faced with a landlord who refuses to repair a property are faced with an un-palatable choice between:

    (a) effecting the repairs themselves and suing for the repair costs;

    (b) suing for an order for specific performance of the landlord's repair obligations; or

    (c) accepting the landlord's repudiation, ending lease and suing for damages.

15. Options (a) and (b) are time consuming and expensive, particularly in a no-cost jurisdiction like VCAT. Setting the repair costs off against rent is also risky, especially if the lease has a "*no set-off*" clause.

16. Option (b) also leaves the tenant in a defective premises until the repairs are completed.

17. Option (c) is risky and tenants have historically been slow to take that option because:

    (a) there are very few reported cases where a landlord has been found to have repudiated a lease; and

    (b) if the tenant cannot show that the landlord has repudiated the lease, then the tenant's purported termination could itself be a repudiation of the lease and could expose the tenant to a significant damages claim from the landlord.

18. As an example of the Tribunal finding that a landlord repudiated a lease by failing to adequately repair and maintain the premises, the Tribunal's

decision offered some comfort to tenants who were considering that option.

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19. The decision of Deputy President Riegler was overturned by Croft J in February 2019.

20. The decision turned on a number of issues. I have summarised what I think are the most significant.

21. **First**, VCAT's decision turned on the construction of various terms of the lease and whether those terms imposed an obligation on the landlord to install and maintain a new air-conditioning at the leased premises.

22. The Tribunal found that the requirement to '*install air conditioning to* ***service****'* the premises was an ongoing obligation that carried with it an obligation to complete major repairs to the air conditioning system throughout the term.

23. Croft J held that this finding was wrong and that:

    (a) the landlord's obligations were satisfied because an air-conditioning system was already in place; and

    (b) the lease did not require the landlord to continue to maintain the air conditioning system and was not ongoing.

24. **Secondly,** the Tribunal held that the landlord's 10 week delay in repairing the air-conditioner was sufficient to constitute a repudiation of the lease. Justice Croft found that:

    (a) as a matter of fact, the landlord did not delay for 10 weeks after being given notice of the need for repair (the Court was quite critical of the tenant's communications); and

    (b) in any event, 10 weeks is not a delay of such an '*inordinate degree*' as to support a finding that the landlord repudiated the lease.

25. **Thirdly,** the Court found that even if there was an ongoing obligation to repair, it was not a fundamental term. This is probably the most interesting finding.

26. The Court extracted the following passage by McHugh JA in *Wood Factory Pty Ltd v Kiritos Pty Ltd* (1985) 2 NSWLR 105 at 144–5, (emphasis added):

> *A contract may be determined, apart from effluxion of time or by agreement, on one of three grounds.* ***First, it may be determined for any breach of a fundamental or essential term:*** *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale [1967] 1 AC 361 at 422; Associated Newspapers Ltd v Bancks (1951) 83 CLR 322 at 337; DTR Nominees Pty Ltd v Mona Homes Pty Ltd (1978) 138 CLR 423 at 430-431.* ***The test whether the term is fundamental is whether it is of such importance to the promisee that he would not have entered into the contract unless he had been assured of a strict or a substantial performance of the promise and that ought to have been apparent to the promisor:*** *Associated Newspapers Ltd v Bancks (at 337).*[1] ***Secondly, a contract may be determined on the ground that the defendant has evinced an intention no longer to be bound by the contract:*** *Freeth v Burr (1874) LR 9 CP 208 at 213.* ***This is the doctrine of repudiation. Thirdly, a contract may be determined on the ground of fundamental breach by the defendant. If the promisor, although wishing to comply with the contract, is nevertheless in breach to such an extent that the promisee's bargain is substantially destroyed, the promisee can put an end to the contract.*** *Some judges have treated fundamental breach as constituting an implied repudiation of the contract: see Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale (at 421-422) per Lord Upjohn and Federal Commerce & Navigation Co Ltd v Molena Alpha Inc [1979]*

[1] Sam's note: a fundamental covenant can be inferred as fundamental and can be agreed as fundamental.

> *AC 757 at 778-779 per Lord Wilberforce. But the better view would seem to be that they are separate categories.* ***Repudiation depends upon the promisor's refusal to carry out the contract. Fundamental breach turns on the objective nature of the breaches whatever the state of mind of the promisor is.*** *It may be, of course, that the objective facts which will constitute a fundamental breach of the contract are also evidence of an intention to repudiate the contract. In many cases the same facts will lead to a conclusion that there is both a fundamental breach and a repudiation. In other cases the objective facts may demonstrate only a fundamental breach.*

27. The Court then found that even if there was an ongoing repair obligation, it would not have been fundamental term because:

    (a) the lease had a fundamental terms covenant that did not include reference to the landlord's repair obligations (para [52]);

    (b) the covenant does not contain a time stipulation, which suggests that it was not fundamental (para [53]); and

    (c) the fact that the air-conditioning is central to the success of the tenant's business does not itself make the clause fundamental (para [55]).

28. At paragraph [56], the Court also relied on the following passage from *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* [1985] 157 CLR 17 at 32-33 per Mason CJ:

> *… repudiation of a contract is a serious matter and is not to be lightly inferred and…****neither*** *a breach of a covenant to pay rent nor* ***a breach of a covenant to repair, without more, constitutes a breach of a fundamental term, nor amounts to a repudiation of a lease.***

29. The Court found that the '*more'* to which Mason J referred was missing in this case.

The significance of the decisions to property disputes

30. The case and its appeal are significant for a few reasons.

31. **First,** historically repudiation by a landlord by failing to repair and maintain has been virtually impossible to establish in the absence of a *Shevill* clause including the repair covenant, as illustrated by Mason J's passage extracted above. I have never seen a *Shevill* clause that includes one of the landlord's obligations.

32. **Secondly,** in recent years there have been a growing number of cases that suggest that landlord's repudiation by failing to repair and maintain is possible. In particular:

    (a) commentators have been alive to the possibility of a landlord repudiating a lease for failing to adequately repair and maintain for some time (see, for example, Bradbrook, Croft and Hay, *Commercial Tenancy Law*, 3rd ed, 2009 at p 259);

    (b) in *Hann Woodlock v ADMR Pty Ltd* [2011] VCAT 1776, Senior Member Walker at VCAT held that a landlord repudiated a lease by failing to undertake certain work that was supposed to be completed prior to the commencement date, although the case Senior Member does not appear to have been given detailed submissions on landlord's repudiation; and

    (c) Croft J alluded to the possibility of a landlord's repudiation by failing to repair and maintain in *Versus (Aus) Pty Ltd v ANH Nominees Pty Ltd* [2015] VSC 515. However, the matter was remitted by Croft J to VCAT for further hearing and Senior Member Riegler ultimately held that there was no breach by the landlord.

33. This line of cases represents the latest attempt to get such a claim up and it is only a matter of time before one is successful.

34. I know of one case that is yet to go to trial in which the landlord (according to the plaintiff):

    (a) failed to maintain an air-conditioning system so that the tenant has re-located; and

    (b) refused to allow the tenant to access the air-conditioning system on landlord's withheld land so that the tenant could arrange inspection and, if necessary, exercise self-help to repair the system, constituting the '*something more*' referred to by Mason J.

35. The tenant is seeking a declaration that the landlord has repudiated the lease.

36. **Thirdly,** the fact that the case succeeded at first instance and then was overturned on appeal, largely for factual reasons, means that a tenant can use similar arguments to exert leverage on a landlord in a dispute.

37. The fact of having a serious argument adds significant context in any dispute, particularly in a no-cost jurisdiction, even if the argument is weak.

Significance for property transaction lawyers

38. For lawyers reviewing leases for tenants:

    (a) consider having the most important of the landlord's repair covenants included in the essential/fundamental terms covenant of the lease so that the tenant can easily establish a repudiation (although I suspect it would be difficult to convince a well-resourced landlord to agree); and

    (b) place time limits on the landlord's repair, maintenance or works obligations and make that time of the essence.

39. Lawyers acting for landlords preparing leases should be aware either of those attempts by the tenant's lawyer.

Final comment – s 52 of the RLA 2003

40. There is a bit of a *'sleeper'* issue buried in the case at first instance.

41. One of the long-standing issues in this area is the extent to which s 52(2)(b) of the RLA 2003 requires the landlord to service air-conditioning, or just to repair defects in that system.

42. Section 52(2) of the RLA 2003 states that (emphasis added):

> *(2) The landlord is responsible for maintaining in a condition consistent with the condition of the premises when the retail premises lease was entered into:*
>
> *(a) the structure of, and fixtures in, the retail premises; and*
>
> *(b) plant and equipment at the retail premises; …*

43. The word *'maintain'* has many meanings. Senior Member Riegler held that:

> *59. The lease was drafted by the Landlord's previous solicitors. As such, any ambiguity in its terms should be construed contra proferentum; namely, against the party that drafted the document.[9] Moreover, read in context, the subclause purports to make the Tenant responsible for servicing the air-conditioning units on a six-monthly basis and the Landlord responsible for any substantial or serious repairs. This would not include repairs of a minor nature associated with the maintenance of the air-conditioning units. For example, replacing filter pads or other consumables.*
>
> *60. Therefore, I find that special condition 1(e)(ii) obliged the Landlord to carry out the repairs to the air-conditioning unit, which included repairs such as replacing the condenser fan. This is consistent with s*

52 of the Retail Leases Act 2003 which requires a landlord to maintain the plant and equipment in a condition commensurate with its condition at the commencement of the Lease. …

62 Accordingly, either special condition 1(e)(ii) or s 52 of the Retail Leases Act 2003 *required the Landlord to carry out the repair and/or replacement of the condenser fan. In reaching that conclusion, I note that s 52 of the* Retail Leases Act 2003 *was not relied upon by the Tenant. However, the Landlord did not, correctly in my view, submit that special condition 1(e)(ii) of the Lease did not operate to bind the Landlord. In those circumstances, it was unnecessary for the Tenant to raise s 52 of the* Retail Leases Act 2003*.*

44. On one view, paragraph [60] extracted suggests that the landlord is only responsible for the rectification of defects on the air-conditioning system and not with regular, routine maintenance. However, the paragraph falls short of actually making a finding to that effect.

45. On appeal, Croft J held that the landlord was not given the opportunity to make submissions about the effect of sub-s 52(2) f the RLA 2003 and that there was, accordingly, a breach of procedural fairness with respect to that issue. The Court did not otherwise express a view on this issue.