

Article Information

Authors: Adam Rinaldi, Tony Britten-Jones

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Case Update - Diakou Nominees Pty Ltd v Gouger Street Pty Ltd & Ors [2017] SASC 72

Can the Retail and Commercial Leases Act 1995 (SA) (Act) start to apply to a lease part way through the term when it did not apply to the lease at the start of the term.

*Can the Retail and Commercial Leases Act 1995 (SA) (Act) start to apply to a lease part way through the term when it did not apply to the lease at the start of the term and can the Act cease to apply to a lease part way through the term when it did apply at the start of the term? In particular, how does the increase in the annual rent threshold from \$250,000 under the Act to \$400,000 which came into force on 4 April 2011 impact on a lease which exceeded the threshold at the time it was entered into, but which is now under the threshold following the 4 April 2011 amendment? **Adam Rinaldi, Senior Associate** and **Tony Britten-Jones, Partner** consider the decision of the Supreme Court of South Australia in *Diakou Nominees Pty Ltd v Gouger Street Pty Ltd & Ors [2017] SASC 72* and the consequences this decision has in respect of leases which were previously excluded from the operation of the Act.*

The Act

The Act applies to most commercial and retail leases in South Australia. The rent payable pursuant to the lease is one of the relevant factors in determining whether or not the Act applies to the lease.

Section 4(2)(a) of the Act previously provided that the Act does not apply to a retail or commercial lease if the rent payable under that lease exceeds \$250,000 per annum.

The Act was amended by the Retail and Commercial Leases Variation Regulations 2010 which came into force on 4 April 2011. The regulations prescribed an amended amount of \$400,000 for the purposes of section 4 of the Act.

The decision of Justice Stanley of the Supreme Court of South Australia in *Diakou Nominees Pty Ltd v Gouger Street Pty Ltd & Ors [2017] SASC 72* provides guidance on how to apply the Act as the rent payable increases above the threshold prescribed in the Act during the term of the lease (including any renewal) and on how to apply the Act where the rent was originally above the previous threshold (with the consequence that the Act did not apply at the start of the lease) but, as a result of the increase in the threshold to \$400,000 on 4 April 2011, the rent was now below the threshold. The Court considered the Act commenced to apply to the lease from 4 April 2011 notwithstanding that was part way through the lease term.

Background

On 1 September 2006 the Talbot Hotel Group Pty Ltd (as lessee) and Diakou Nominees Pty Ltd (as lessor) (**Diakou**) entered into a lease of commercial premises in Gouger Street, Adelaide, known as the Talbot Hotel. The lease was for a term of five years commencing on 1 September 2006 and there were six rights of renewal each for a further five year term.

Under the lease the commencing rent was \$250,500 per annum (exclusive of GST).

The lease provided that every five years the annual rent would be reviewed to the greater of current market rent and the rent prior to the review date, increased by four per cent.

On 8 July 2007 the lease was assigned by the Talbot Hotel Group Pty Ltd to Schillvest Pty Ltd.

When the lease commenced on 1 September 2006 the Act did not apply to the lease because the annual rent payable at that time exceeded \$250,000.

As at 4 April 2011 and at all times thereafter (including when the lease was renewed on 1 September 2011), the annual rent payable under the lease has been less than \$400,000.

The first right of renewal was exercised and the lease was renewed for a five year term commencing on 1 September 2011.

On 13 June 2012 receivers and managers were appointed to Schillvest Pty Ltd. On 2 July 2013 the lease was assigned by the receivers and managers of Schillvest Pty Ltd to Gouger Street Pty Ltd (**Gouger Street**) with the consent of Diakou. Gouger Street commenced occupation of the Talbot Hotel on 2 July 2013.

The lease contained provisions which conferred the following rights upon the lessor:

- a right to be paid annual and five-yearly increases in rent (with a ratchet preventing any decrease) – specifically the lease provided that upon renewal the rent would be increased to the higher of current market rent or a four percent increase; and
- a right to receive payments from the lessee on account of land tax and an obligation on the lessee to pay land tax.

The issue for determination was whether the Act applied to the lease once the annual rent fell within the new higher threshold amount prescribed under the Act.

This was a significant commercial issue for the parties as if the Act commenced to apply to the lease the provisions of the lease identified above would cease to be enforceable and the lessor would be precluded from:

- recovering land tax from the lessee (refer to Section 30 of the Act)
- adjusting rent in accordance with whichever two methods of calculating the change would result in the higher rent (refer to Section 22(3)(c) of the Act); and
- disallowing a decrease in rent (refer to Section 22(4) of the Act).

The Decision

The Court rejected Diakou's arguments that:

- the Parliament did not intend the Act subsequently to apply to the lease in circumstances where the Act did not apply to the lease at its commencement;
- the parties to the lease had acquired existing rights and obligations under lease which were not to be interfered with by a subsequent amendment to the Act increasing the prescribed sum for the purpose of section 4(2)(a) of the Act; and
- the original parties to the lease contracted out of the application of the Act for up to 35 years by agreeing at the commencement of the lease a rental in excess of the prescribed amount.

Justice Stanley held that the lease was subject to the operation of the Act on and from 4 April 2011 and as renewed from 1 September 2011. Justice Stanley was not persuaded by Diakou's argument that the threshold when the lease was entered into was the threshold to govern the lease for the duration of its term as this was clearly intended by the parties. His Honour considered that Parliament intended that once the annual rent did not exceed the prescribed sum the Act should apply. Importantly, his Honour held that:

"Whatever 'rights' existed pursuant to the lease before 4 April 2011, when s 4(2)(a) was amended, the Act evinced an intention that the lease was to be regulated by its provisions for so long as the annual rental payable did not exceed the prescribed amount. The Act would operate prospectively in the sense that the Act would interfere with those 'rights' created by the lease from the date of the amendment and not before."

In the context of the facts of the case, his Honour held that:

- the rent review provisions applicable upon the September 2011 rent review were subject to the provisions in the Act regulating rent reviews; and
- Diakou was precluded from the requiring payment or reimbursement of land tax levied from 4 April 2011.

Consequence

The consequences of this decision are that:

- leases which were not subject to the Act on 3 April 2011 on the basis of annual rent being above \$250,000 become captured by the Act on 4 April 2011 (being the date when the threshold had changed) where the annual rent was less than \$400,000; and
- if a lease is captured by the Act on 4 April 2011 the lessor cannot recover land tax from the lessee from that date,

the lessor is unable to enforce any “rent ratchet” clause that might apply to market rent reviews and all other requirements of the Act also apply.

The Court did not mention GST and whether the threshold is inclusive or exclusive of GST. This issue remains unclear. The conservative approach would be to assume that the threshold is GST exclusive.

The decision provides clarity on the operation of section 4(2)(a) of the Act and expands on the Supreme Court’s decision of *WST Pty Ltd v GRE Pty Ltd & Ors* [2012] SASCFC 146 which is authority for the proposition that a lease will remain a retail shop lease until such time as the rent exceeds the applicable threshold amount whatever it may be from time to time. In that case, the lessee was not liable to pay land tax from 21 May 2011 as the annual rent payable at that time was below the then applicable threshold of \$400,000. The Court in that matter did not consider whether the Act would commence to apply if the annual rent was above the threshold and later reduced below the threshold. However, the decision of *Diakou Nominees Pty Ltd v Gouger Street Pty Ltd & Ors* [2017] SASC 72 clarifies the position on this matter.