A Sad State of Repair – Liability for Maintaining Leased Business Premises

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Abstract

Covenants for the care and maintenance of business premises receive little attention when leases are negotiated, yet these covenants often cause arguments later because of onerous or uncertain liabilities. When repair or outgoings covenants are not explicit, current laws provide little protection for either the landlord or the tenant. Generally, landlords' solicitors draft covenants to the advantage of landlords but legal disputes are endemic. This article suggests ways in which the lease covenants that govern the repair and management of business premises could be drafted to achieve more harmony.

Introduction

Many arguments between landlords and tenants concern the care and maintenance of business premises. Landlords seek to protect their long-term investment in the leased property whilst tenants require space in which to make profits during the lease. These different objectives lead to conflicting approaches to the care of leased premises.

Care of the premises extends to all aspects of building management, insurance, and contesting or settling government charges. However, it is the issue of repair that has always proved the most contentious.[1] The laws governing repair liabilities are the cause of much uncertainty and ill-feeling between the parties, leading sometimes to costly disputes.

The repair covenants in leases establish who is to maintain leased premises. There may be separate 'outgoings' clauses enabling the landlords to recover the cost of some or all of the building operations from the tenant. Most tenants of small businesses ignore warnings that their leases contain repair covenants with onerous, sometimes hidden, liabilities. Furthermore, they do not realise how little the law protects them if their premises become defective.[2]

The Inadequacy of Repair Laws

The Australian law of landlord and tenant is a mixture of legal rules that can be traced back to agricultural tenancies in 13th century England and were moulded by 19th century disputes concerning housing tenancies. Particularly in the area of repair responsibilities, English and Australian courts have been reluctant to overturn precedents that may have been appropriate under different social and economic conditions.[3] These

[1] As noted by Redfern, M. J. and Cassidy, D.I., *Australian Tenancy Practice and Precedents,* Looseleaf edition, Sydney, Butterworths, Sydney, 1987, p2852; and Barnett, T., *Drafting and Negotiating Commercial Leases in Australia,* Sydney, Butterworths, Sydney, 1990, p62.

[2] Most tenants give scant attention to repair covenants they are preparing to start business in new premises and negotiating leases. See Barnett, *ibid*, p56; Apgar, M., 'Uncovering Your Hidden Occupancy Costs', *Harvard Business Review,* 1993, Vol. 71, pp124-136; and Spittles, D., 'Beyond Repair', *Management Today,* December 1998, pp78-80.

[3] See Bradbrook, A. J., 'The Evolution of Australian Landlord and Tenant Law' in (editors) M. P. Ellinghaus, Bradbrook, A.J. and Duggan, A.J., *The Emergence of Australian Law,* Sydney, Butterworths, 1989, pp104-143 at 143.

precedents remain the basis for much of the law that governs commercial tenancies in Australia today, except for some recent statutory variations for retail establishments (as defined in State legislation). It is not surprising that the common law fails to protect the interests of either party satisfactorily.[4] Four specific weaknesses of the common law have been identified.

No implied covenant to repair

Firstly, in the absence of a specific repair covenant, the common law does not imply a covenant that the landlord should repair non-residential premises at the start of or during the lease[5] except to look after the means of access if it is under the landlord's control. Tenants are under an obligation to use the premises in a 'tenant-like manner'.[6] This term, even following judicial consideration, is vague. It is probably limited to avoiding neglect and to carrying out little jobs such as cleaning windows and replacing blown light bulbs.[7]

The unwillingness of the courts to imply repair obligations has left serious gaps in any oral or poorly drafted leases. Although it would be rare to find any lease without a repair covenant, the legacy of this case law is that the courts will rarely imply any obligation to repair premises that is not specifically stated in the lease. Therefore, the law is of little help in determining liability for repairs of an unanticipated type (such as compliance with new workplace regulations) or in sorting out ambiguous repair covenants.

Problems in interpreting repair covenants

Secondly, ascertaining the nature and extent of repair covenants has caused great difficulties. Although (or perhaps because) the judiciary have insisted that repair should be given its 'ordinary meaning',[8] the guidelines that have emerged from the many reported cases are difficult to fathom.

In defining the extent of the liability to repair, the following circumstances, amongst others, are to be considered:[9]

- the age, nature and locality of the property;
- the condition of the premises at the start of the lease;
- the extent and cost of the remedial action (in relation to the value of the building);
- the wording of the repair covenant; and
- the other terms of the tenancy, including the lease length.

Although Smith describes the scope of any covenant to repair as subject to 'a test of the facts and the degree', this test 'is inherently imprecise and leaves liability in marginal cases to be resolved subjectively'.[10]

Repairs do not include 'renewing substantially the whole' - although rebuilding the front wall completely and renewing the entire roof have been held to be repairs.[11] Whether a tenant is liable for the repair of inherent defects is not clear in Australia.[12] Both the volume of case law and the occasional discrepancy in the ways in which authors interpret the cases indicate a

[4] As discussed by Hood, A., 'The Extent of the Modern Covenant to Repair in Commercial Leases', *Australian Property Law Journal,* 1997, Vol. 5, pp53-73.
[5] *Hart v Windsor* (1843) 12 M & W 67; 60 All ER 681.
[6] *Horsefall v Mather* (1815) Holt NP 7.
[7] Further commentary can be found in Bradbrook, A. J. and Croft, C.E., *Commercial Tenancy Law in Australia,* 2nd edition, Sydney, Butterworths, 1997, p159.
[8] *Lurcott v Wakely & Wheeler* (1911) 1 KB 905.
[9] The relevance of these circumstances are expanded upon in Bradbrook and Croft, *ibid*, footnote 7, p185; Hood, *ibid*, footnote 4, p55; and Neave, M. A., Rossiter, C.J. and Stone, M. A., *Sackville and Neave Property Law Cases and Materials,* 6th edition, Sydney, Butterworths, 1999, p691.
[10] Smith, P. F., 'Repairs - A New Set of Problems', *Conveyancer and Property Lawyer,* September-October 1990, pp335-347 at 335.
[11] In *Lurcott v Wakely & Wheeler* (1911) 1 KB 905 and *Elite Investments v TI Bainbridge* (1986) 2 EGLR 43 respectively.
[12] See Duncan, W. D., 'Covenant to Repair and Inherent Defects - A Game of Change?', *Australian Property Law Bulletin,* 1987, Vol. 2 No. 4, pp47-50; or Neave, Rossiter and Stone, *ibid*, p698.

failure of the common law to define the limits of repairing obligations.

The uncertainty is compounded by lease clauses that divide the building responsibilities or exclude liability for some elements of repair. The common exceptions from tenant's repair covenants for 'fair wear and tear' and for structural repairs have led to many disputes in which expensive liabilities have turned on the meaning of these words.[13] The exception of fair wear and tear from repair liability may be of little practical significance because tenants remain responsible for damage flowing from fair wear and tear.[14] Exempting a tenant from liability for structural or other repairs does not automatically shift that liability to the landlord as neither party is responsible without an express covenant.[15] Even the apparently simple distinction between internal and external repairs leaves unclear the responsibility for windows, doors and walls common to other tenancies.

Limited remedies for disrepair

Thirdly, unless specific provisions are included in a lease, there are limited remedies for failure to keep premises in repair. Under most circumstances, neither the landlord nor the tenant can obtain a court order forcing the other party to carry out repairs.[16] The parties can not generally terminate the lease even for severe disrepair.[17]

At common law, a breach of a landlord's covenant to repair or supply services does not alter the tenant's obligations, including the payment of rent.[18] A tenant might withhold rent to persuade the landlord to carry out repairs and, if sued for arrears of rent, the tenant could enter a plea of (equitable) set-off of rent against the cost of repairs.[19] However, there is a risk that withholding rent might give the landlord grounds for evicting the tenant.[20]

The main common law remedy for disrepair is to sue the party in breach for damages, representing the costs of repair and any losses that were caused by the failure to repair. The latter are often difficult to prove. Most leases explicitly give the landlord powers to forfeit the lease for any breach of a tenant's obligation to repair or to enter, repair and recover any costs (as debts). Leases rarely specify wider powers for tenants than their common law rights against landlords who fail to repair.

The isolation of repair from insurance covenants

Fourthly, the link between repair and insurance covenants has sometimes proved controversial, as the courts are reluctant to recognise their interdependence. Repair covenants may exclude accidental or insurable damage, presumably because this damage will be recovered from insurers. However, at common law, landlords are not obliged to spend insurance monies on repairing damages caused by fire. Some leases require tenants to contract out of the statutory rights to insist that insurance monies are spent on reinstatement.

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[13] See, for example, *Halsbury's Laws of Australia,* looseleaf edition, Sydney, Butterworths, 1991, p453,384; and Redfern and Cassidy, *ibid*, footnote 1, p2850.2.

[14] See Bradbrook and Croft, *ibid*, 1997, p188. This was reaffirmed in *Reilly v Langis Investments Pty Ltd* (2000) NSWSC 47, in which the judge stated that failure of tile adhesive over time was fair wear and tear but the tenant was liable when the tiles subsequently 'popped up'.

[15] The courts recently insisted that a landlord carry out sufficient external repairs to enable the tenant to comply with a covenant to repair the interior (*Barrett v Lounova* (1982) Ltd (1990) 1 QB 348; 1 All ER 351).

[16] Butt, P. in 'Specific performance of tenant's repairing covenant', *Australian Law Journal,* 1999, Vol. 73 pp17-18, describes a recent exception to the rule in *Hill v Barclay* (1810) 16 Ves Jun 402; 33 ER 1037. In *Rainbow Estates Ltd v Tokenhold Ltd* (1998) 3 WLR 980; 2 All ER 860, a landlord was granted specific performance under an unusual lease.

[17] Bradbrook and Croft, *ibid*, footnote 7, at pp357-382, explain how the contractual doctrines of frustration and repudiation may now be available if the disrepair prevents the use for which the premises have been leased.

[18] This principle was reaffirmed in *Bishop v Moy* (1963) NSWR 468.

[19] Neave, Rossiter and Stone, *ibid*, footnote 9, p744.

The position is complicated when the party insuring is not the party responsible for repair. In one case, a landlord was not obliged to use insurance monies to reimburse a tenant who was liable for and carried out repairs to fire damage.[21] In another case, the landlord successfully sued the tenant for the cost of repairing fire damage caused by the tenant's negligence although the damage was covered by the landlord's insurance.[22] In both cases, the tenant had reimbursed the landlord's insurance premium and could have avoided losses if they had been named as insurers.

Typical repair covenants in non-residential leases

Because the common law does not establish a clear allocation of repair obligations, carefully worded repair covenants are essential. The typical repair covenants found in current commercial leases were developed by solicitors to protect landlords against the shortcomings of the common law. In the 20th century, three features of repair and outgoings covenants became pronounced.[23]

First, covenants for the tenant to repair are comprehensively worded and either spell out precisely how the tenant should care for the building or stipulate a standard of care 'reasonably required by the landlord'. An example of this is the detailed provision for redecorating which commonly specifies the frequency of painting, the number of coats and the type of paint. Typical repair covenants give landlords substantial powers, including forfeiture for failing to deal with minor defects. This is a heavy stick when a carrot might be more effective.

Second, the landlord's obligations are not spelled out or are vague, in order to take advantage of the unwillingness of the courts to imply or enforce imprecise obligations to repair. For example, those commercial and industrial leases which exempt tenants from responsibility for structural repairs often do not state that the landlord will carry out these structural repairs.[24] Instead, landlords may reserve the right to enter to carry out repairs at their discretion.[25]

The third feature has been the widespread adoption of leases which provide for the landlord's costs of repair to be recovered from the tenant as part of a service charge. Sometimes, the lease does not specify exactly what repairs or services the landlord is to provide but any costs or 'outgoings' may be recovered from the tenant. The use of service charges gives landlords control of the maintenance and management of the leased properties at the tenants' expense. For multi-tenanted buildings, it would be impractical for the tenant to be responsible for the exterior and common areas but service charges are also used for many single tenant office, retail and industrial properties.

Service charges are easier to enforce than covenants for the tenant to repair. Legal action to recover the costs of the landlord's repairs is more likely to be successful than an injunction forcing the tenant to repair. This is because most leases specify that service charges are to be treated as part of the rent, are due even if not demanded and non-payment gives rise to immediate rights to forfeit.

Reasons for the imbalance in repair covenants

Repair and outgoings covenants in commercial leases do little to protect tenants against the vagaries of the common law or against unscrupulous landlords. This

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[20] Weir, M. J., 'A Tenant's Right of Set-off', *Australian Law Journal,* 1994, Vol. 68, pp857-873 at 862.

[21] *Linden v Staybond Pty Ltd* (1986) NSW Conv R 55-308.

[22] *Bit Badger Pty Ltd v Cunich* (1996) 9 ANZ Ins Cas 61-312; QConv R 54-478.

[23] The analysis here is based on Redfern and Cassidy's *Australian Tenancy Practice and Precedents*, *ibid*, footnote 1, p12,099 and p12,557; precedents for single and multiple tenancies given by Barnett, *ibid*, footnote 1, p122, p163 and p190; repair covenants transcribed in recent court cases and other specimen leases viewed by the author.

[24] Barnett, *ibid*, footnote 1, p64; and Duncan, W. D., *Commercial Leases,* 2nd edition, Sydney, Law Book Company, 1993, p107.

may be explained by landlords' dominance in some markets: 'That there are problems inherent in the disparity in bargaining power between shopping centre landlords and small retail tenants has long been recognised'.[26] However there are also markets in which competing landlords have been keen to lease large amounts of vacant space, such as City offices in the early 1990s. In these markets, rents may have dropped dramatically but the wording of repair and outgoings covenants did not change.

However, the major reason why repair and outgoings clauses are largely for the benefit of landlords is that the landlords' solicitors control the drafting of leases. The typical steps leading to a commercial lease begin with the landlord and the tenant (or their agents) agreeing the rent, critical lease dates and a broad notion of how the property responsibilities will be allocated. These terms may be set down in a letter of 'heads of agreement' or 'an agreement to lease'.

The harshness of tenant's obligations to repair and pay outgoings may be at least partially attributed to the tenants' ignorance of the law when they are negotiating to lease. 'Frequently the lessee's understanding of his or her [repair] obligations at the time of taking the lease is as imperfect as his or her subsequent performance of them.'[27]

The solicitor for the landlord draws up the lease document, usually fitting the agreed terms into one of the model leases in the solicitor's office. These may be standard leases that have been agreed with a major property investor or are adopted for all the tenancies in one office tower or shopping centre. Each model lease may have slightly different versions of repair and outgoings clauses, defining the required repairs, the types of insurance and how and which operating costs will be recovered from the tenant.

At this stage, the solicitor often does not consult the landlord over the detailed provisions for repair and

[25] Barnett, *ibid*, footnote 1, p123.
[26] Standing Committee on Industry, Science and Technology, *Finding a balance Towards fair trading in Australia,* Canberra, Australian Government Publishing Service, 1997, p17.
[27] Bradbrook and Croft, *ibid*, footnote 7, p182.

outgoings. The initial negotiation of terms is divorced from the preparation of the lease.[28] The draft lease is sent to the tenant's solicitor who has the opportunity to suggest amendments. However, there is a long tradition of repair and outgoings covenants that favour the landlord, making it difficult for tenants' solicitors to oppose the normal wording unless the issue had been raised at the time when the rent was negotiated.

Because the lease is submitted to the tenant's solicitor as a complete document, the landlords' wording is likely to prevail. Legal practice frowns on amending another solicitor's draft unless clauses do not express the intentions of the parties.[29] It is common practice (and an excellent negotiating ploy) for the tenant's solicitor to receive only an engrossed lease, supposedly ready for signing.[30]

Sometimes, a further impediment to correcting imbalances in the draft lease may be the priorities of the tenants, who are generally anxious to gain possession. The tenants themselves may put pressure on their solicitors to overlook unfavourable provisions in the lease because landlords rarely permit occupancy until the lease is signed.

Evidence of continuing disputes

Although landlords may be content to benefit from the ineffectiveness of the common law, repair and outgoings covenants continue to cause many disputes. The Table[31] below illustrates the types of disputes that have reached some of the higher courts around Australia in the last five years.

Table of issues in recent disputes

Liability for	compliance with a fire safety order
	injury caused by a broken fence
	disrepair excluded from the tenant's covenant
	injury suffered in common areas by tenants' customers (3 cases)
Whether	prevented lease from starting
	prevented forfeiture for arrears (2 cases)
Measures of damages	when tenant forced to vacate an unsound building
	when landlord failed to repair air-conditioning essential for tenant's business
	for loss of use whilst landlord carried out repairs
Landlord seeking possession	as tenant exercising option to renew was in breach of his repair covenant
	as lease permitted termination if major repairs required vacant possession (2 cases)
Meaning of	good and substantial repair
	fair wear and tear (2 cases)
	structural repairs
	storm damage
	weatherproof
	outgoings (in agreement to lease)
Outgoings disputes over	method of apportionment
	recovery of management and secretarial fees
	recovery by way of sinking fund
	recovery of strata levies (2 cases)
	remedy for non-payment if rent accepted

Forces for change

Despite continuing legal disputes, it is likely that repair and outgoings liabilities will not change significantly until one of three occurrences. First, statutes might be enacted enforcing a code for repair covenants. There are already mandatory repair covenants in residential leases in Australia and some provisions regarding the condition of shops at the start of leases and common areas during leases. There does not appear to be political pressure for statutes that insist on particular forms of repair and outgoings covenants for other types of

[28] Barnett, *ibid*, footnote 1, p64.
[29] Barnett, *ibid*, footnote 1, p8.
[30] Barnett, *ibid*, footnote 1, p6.
[31] The cases referred to in this table were found in three electronic databases (Pink Ribbon Publishing's *CaseBase*, the Australian Legal Information Institute (AUSTLII) web site and the Western Australian Supreme Court records). All were cases heard in the last five years in the Supreme Courts or Courts of Appeal in New South Wales, Queensland, Australian Capital Territory and Western Australia. The cases in these jurisdictions show how repair and outgoings covenants in non-residential leases remain problematic. They are not a full list of recent relevant Australian cases.

property and therefore the common law is likely to prevail.[32]

Secondly, other areas of judge-made law might be utilised to extend landlords' obligations to tenants beyond those implied by the law of landlord and tenant. Landlords have been sued in negligence for injury suffered by residential tenants and their invitees caused by building defects.[33] Builders have been sued in negligence by second owners of homes for initial construction defects[34] and, similarly, tenants might be able to sue their landlords' builders, instead of trying to enforce a covenant to repair by the landlords.[35] However, it is doubtful whether the courts will extend these findings of negligence to a commercial context (in which the parties are usually expected to fend for themselves). Potentially, actions in negligence could bypass ineffective covenants to repair by landlords.

Substantial changes to repair liabilities are only likely to occur when more business people take their future responsibilities for the care of leased premises seriously. If tenants think about the extent of their liability for repair and outgoings at the time of lease negotiations, they might insist on more balanced covenants. Several of the recent cases in the Table above provide examples of tenants treated in a manner that appears unfair but which is consistent with their lease covenants.[36] For the reasons above, tenants' solicitors are only likely to propose new covenants at the request of their clients.

Alternative covenants for repair and outgoings

The following suggestions are put forward as ways of diffusing the usual friction points between landlords and tenants. Both landlords and tenants would benefit from repair and outgoings covenants that give more incentive to protect the other party's interest in the property. Any methods of making it easier to monitor and enforce covenants to maintain and manage will also lessen the volume of disputes.

Problems are created when major responsibilities are given to a landlord or tenant with little immediate interest in the property. The length of the lease determines largely which party has the more valuable interest in the property. At the extremes, a tenant for six months will resist any obligation to repair and a landlord who has granted a twenty year lease will be reluctant to carry out repairs during the early years. The first suggestion is that the allocation of responsibilities for the property should be more closely linked to the length of the lease. In leases of more than approximately ten years, the tenant should be liable for repair; in leases of approximately ten years or less, the landlord should be liable for repair (excluding internal decoration).

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[32] Most branches of property law in Australia are now governed by statutes which are interpreted by the courts. Bradbrook, *ibid*, footnote 3, p142, advocated the codification of the law of landlord and tenant in Australia. In England, the Law Commission, 'Responsibility for the State and Condition of Property', Report No. 238, London, HMSO, 1996, para 6.22, proposed a 'coherent and principled code regulating the responsibilities of the parties to a lease'. However, it seems likely that the dominance of the common law will remain in both countries.

[33] *Northern Sandblasting Pty Ltd v Harris* (1997) 188 CLR 313; 146 ALR 572 and subsequent cases.

[34] *Bryan v Maloney* (1995) 128 ALR 163.

[35] This is foreseen by Stanfield, A., 'The Shifting Foundations Underlying Repair Covenants and how They Affect the Landlord, the Tenant and Third Parties', *The Queensland Lawyer,* 1996, Vol. 17 pp23-30 at 28.

[36] Several of these recent cases echo the judicial approach of the 19th century: 'There is no law against letting a tumbledown house' (*Robbins v Jones* (1863) 143 ER 768 at 776).

Problems are also invited when the control of the operations is separated from their payment. This is what a service charge does. Disputes and suspicion arise because tenants believe that they are being asked to pay for building services that do not benefit their businesses. 'Gross' leases, except for lengthy terms, would be less controversial than 'net' leases with service charges (although the landlord could argue for extra rent for bearing the risk of unexpected operating expenses).

These allocations of building responsibilities would lessen but not avoid conflicts. Other provisions could encourage proper maintenance and management, rather than punish breaches of covenant. This might include rent reductions for tenants who keep or put premises in good condition (perhaps given when options to renew are exercised) or stepped annual rental increases that only take effect if the landlord complies with repairing obligations. Mechanisms for joint decisions concerning property operations (and, if service charges are retained, joint setting of outgoings budgets) might cause short delays but would reduce subsequent disputes.

Measures which place the responsibility for maintenance in the hands of independent building managers (reporting to both the landlord and the tenants) are radical but might be worth considering. A more moderate step would be for tenants to insist on a definition of the landlords' responsibilities that is as specific as the current definitions of tenants' responsibilities. The tenant should know precisely which aspects of building operations the landlord will look after and approximately how quickly works will be carried out. It would be reasonable to require the landlord to consult the tenant if major works are proposed.

Precise definition of responsibilities is pointless unless the lease contains proper means for the tenant to enforce the covenants to maintain and manage the building. The emphasis should be on remedies that keep the building in good order and safeguard all necessary services, rather than powers to terminate the lease. For example, it is arguable that the tenant should be entitled to withhold rent and put this towards rectifying any breach by the landlord (after receiving notice), rather than threatening to repudiate the lease.

There is already wide use of tenants' security deposits (or bonds) to reduce neglect of premises, particularly towards the end of the lease. Joint security deposits, to which both the landlord and tenant contribute, could be set up and utilised if either party did not meet its repair obligations. In the event of disagreement over the need for or cost of works, there could be provision for swift independent settlement with rights to arbitration. Imaginative tenants, cooperative landlords and their solicitors could think of many other ways of designing repair covenants which operate for the benefit of both parties.

Conclusion

Typical covenants to repair and recover outgoings continue to cause many disputes between landlords and tenants. The covenants rarely encourage cooperation between the two parties sharing interests in the one property. They tend to be vague about the landlord's obligations but precise about the tenant's. Neither side can quickly and inexpensively enforce the repair obligations, although the landlord reserves draconian powers. There is little incentive for landlords, whose solicitors control the drafting of the lease, to change the typical repair and outgoings covenants found in commercial leases. Until such time as tenants treat the care of the property as a significant issue in their lease negotiations, they will not be protected against the effects of major disrepairs or excessive service charges.