The curse of the option

The curse of the option has struck again, this time in the decision of the NSW Court of Appeal in *Willis Australia Ltd v AMP Capital Investors Ltd* [2023] NSWSC 158.

In this case, the tenant leased the whole of level 16 and part of level 15, in Angel Place, Pitt Street.

The lease contained a conventional option to renew plus an expansion space option. In effect, if the tenant exercised the option to renew the existing lease, it also had the option to require AMP to lease it expansion space, being the balance of level 15.

The conditions the tenant needed to satisfy in order to exercise the options were in the main pretty familiar: the tenant had to serve notice of exercise at least nine months before the expiry date of the lease, and the tenant was not to be in breach.

In addition, the obligation to grant the new leases was conditional on the tenant delivering the new bank guarantees for the further leases before the expiry date of the lease on 30 September 2020.

While not uncommon, this was a slightly unusual condition. It turned out to be disastrous for AMP.

In pre-Covid December 2019 the tenant served two formal notices of exercise of the options on AMP: one for the existing space, and one for the expansion space.

At the time of serving the notices, the tenant satisfied all of the conditions of the option clauses, but for the condition requiring delivery of the bank guarantees. But this condition was drafted so that the bank guarantees could be delivered at any time before the expiry date in September 2020. So the options had be exercised in December 2019, but you had to wait until the expiry date of the lease in September 2020 to find out if the conditions for valid exercise had been satisfied.

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On receipt of the expansion space notice of exercise of option, AMP kicked out the tenant who was then sitting in the expansion space. While not stated in the judgement, we can safely assume that the rent payable on the expansion space was serious money, particularly in the Covid affected 2020 office rental market.

Then, in August 2020, the tenant wrote to AMP advising that it withdrew its notice of exercise in relation to the expansion space, and that it would not be taking up the expansion space lease.

AMP commenced proceedings for orders that the tenant was bound by the notice of exercise and was required to enter into the expansion space lease. It conceded that by the time the tenant withdrew the option notice, it had not satisfied the condition requiring delivery of the bank guarantee, but contended that this condition was entirely for AMP's benefit and therefore AMP could waive it.

Not so said the Court of Appeal in a unanimous judgement.

The court followed the decision of the NSW Full Court in *Gilbert J McCaul (Aust) Pty Ltd v Pitt Club (1957) 59 SR* (NSW) 122 1957 to hold in effect that the option clause granted a right to the tenant. It granted no rights to the landlord. The option clause granted to the tenant the right to a further term.

In order to enliven that right, the tenant had to perform the conditions in the option clause. Having a failed to perform all of those conditions, the right to the expansion space lease had not been engaged.

The landlord had no rights under the option clause. It had no right to require the conditions in the option clause to be performed. It therefore had nothing to waive.

Therefore, the expansion space option had not been validly exercised, and the tenant was not required to take the expansion space lease.

While there is no complaint about the judgement of the court, which appears to me to be impeccable, this was a brutal result for AMP.

When you think about it, the drafting of its expansion space option clause wedged AMP between a rock and a hard place.

As we have seen, it was a condition of the clause that the tenant had to deliver the new bank guarantee by the expiry date. But when the tenant served notice of exercise, AMP had to take steps to kick out its sitting tenant, so that it would be able to deliver the expansion space if the option conditions were ultimately delivered.

Better, in hindsight, if this condition had never been included. Without it, the option would have been validly exercised and everyone would have known where they stood. The lease for the further term embedded in it a condition for the new bank guarantee from the commencement date, so the entitlement to the bank guarantee was secure.

More conventional option clauses roll on this basis.

The case also served as a timely reminder about the care needed when drafting option clauses. At [51] it referred to the decision in *Miwa Pty Ltd v Siantan Properties Pte Ltd* [2011] NSWCA 297.

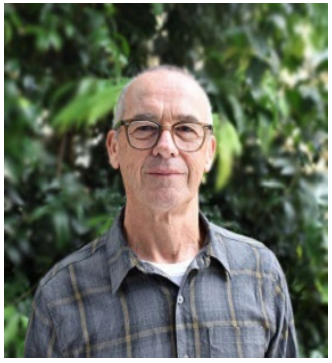
In that case, the lease stated that the tenant would pay the landlord $45,000 on the commencement date, for a new fitout of the premises. The option to renew did not exclude the operation of that clause from the renewed lease. The court held that this provision was therefore correctly repeated in the new lease.

This decision was approved by the Court of Appeal in *International Petroleum Investment Company v Independent Public Business Corporation of Papua New Guinea* [2015] NSWCA 363 (see [55]) on the basis that the court "*has no mandate to rewrite agreements, to merely give them a more commercial operation*".

Unless the outcome is absurd, the court will not disturb the drafting, and absurdity will not lightly be inferred (see [52] to [60] of the judgement in this regard).

The lesson from these observations is clear: pay attention when drafting option clauses and be sure to exclude first term incentives from the lease for the further term.

As I have been heard to remark more than once: attention to detail is the difference between a rooster and a feather duster.



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Speirs Ryan is a Sydney based boutique property law firm with national coverage. The firm is uniquely placed with specialist teams in both property transactions and strata law.

7 December 2023